THE BROKEN BUDGET PROCESS: LEGISLATIVE PROPOSALS

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HOUSE OF REPRESENTATIVES

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THE BROKEN BUDGET PROCESS: LEGISLATIVE PROPOSALS

THURSDAY, MAY 31, 2012

HOUSE OF REPRESENTATIVES,
COMMITTEE ON THE BUDGET,
Washington, DC.

The committee met, pursuant to call, at 10:05 a.m. in room 210, Cannon House Office Building, Hon. Paul Ryan [chairman of the committee] presiding.

Present: Representatives Ryan of Wisconsin, Simpson, Calvert, Cole, Price, McClintock, Stutzman, Ribble, Flores, Mulvaney, Huelskamp, Young, Van Hollen, Bass, and Bonamici.

Chairman RYAN. The committee will come to order. So much for—we are cutting back on gavels around here. Welcome to House Budget Committee. The purpose of today's hearing is to examine the need to restore responsibility and accountability to how Washington spends its taxpayers' hard earned dollars. The breakdown of responsible budgeting is clear, out of control government spending. Four consecutive trillion dollar deficits and a crushing burden of debt in the years ahead. Both political parties share the blame for our fiscal mess.

I believe it will require both political parties to work together ultimately to find common ground and to right this fiscal ship. Unfortunately, current leaders in the Democratic-controlled Senate and the White House have failed to step forward with solutions to match the magnitude of our challenges. The United States Senate has failed to pass a budget in over 3 years. They didn't even propose a budget this year or the last year. And the President has punted on the key economic and fiscal challenges of our times with budgets calling for even more spending, higher taxes and empty promises that are quickly becoming broken promises if we don't fix these problems soon.

This failure of leadership not only undermines America, it undermines the America our children will inherit tomorrow. It also stifles confidence in economic growth today. While budget process reform alone cannot solve our budget problems, we can strengthen this process and provide additional tools to help address the enormous budget problems we face. This is a good step in the right direction. Budget process reform alone is not a substitute for the political courage and leadership required to address our core of spending and the entitlement challenges. I don't think there is any doubt about the failure of the Federal budget process, but there are big differences in opinion on how to tackle these challenges and how to address these failures.

Despite these differences, the ranking member and I were able to work out on a bipartisan basis to report out of this committee and pass on the floor the Expedited Legislative Line Item Veto and Rescissions Act. This committee has also advanced baseline budget reform, Budget and Accounting and Transparency Act, the Pro-Growth Budgeting Act, and today we continue the committee's efforts to bring greater transparency to the budget process.

Mandatory spending, or what we consider autopilot spending, accounts for 60 percent of the Federal budget. Through the Budget Control Act passed last summer, Congress has established statutory limits on discretionary spending with enforceable spending caps. Implementing similar statutory controls on mandatory spending will help ensure the Federal Government can deliver on its promises with sustainable entitlement programs and a sustainable fiscal future.

To that end, committee member John Campbell of California has introduced the Spending Control Act. Another criticism of the budget process is the failure to account for future consequences of today's decisions. As we develop the budget and consider legislation, we currently focus solely on the 10-year budget window, not taking into account the long-term impact of current programs or proposed legislation. The sole focus of the 10-year window can also lead to accounting gimmicks that perversely worsen our long-term budget problems. This is something that was identified in the joint effort by the Heritage Foundation and the Brookings Institution, two of whom we have representatives from today.

We need to improve the way Congress budgets in the long term and better assess the long-term implications of its policies.

Mr. Mulvaney has introduced legislation to get that Federal Government to the budget for the long term. And Mr. Chaffetz has introduced a bill to bring greater scrutiny to Federal spending. In addition to these bills, Mrs. Black has introduced legislation to give the budget the force of law, Mr. Ribble would reform the process to move to a biannual cycle, and Mr. Lankford would remove the threat of government shutdowns.

So just the members of this committee have put forward a robust set of proposal to reform and strengthen the budget process. To help further advance this budget process reform conversation, we welcome three terrific witnesses today. We have Dr. Doug Holtz-Eakin former CBO director, no stranger to this committee and the current President of the American Action Forum and an expert on the budget, he is back with us today.

We have Alison Fraser, Director of the Thomas Roe Institute for Economic Policy Studies at The Heritage Foundation. And also no stranger to this committee, Henry Aaron, a senior fellow of economic studies at the Brookings Institution. All three bring expertise to this conversation, they have been around these budget debates for a long time and we look forward to your testimony.

[The prepared statement of Chairman Ryan follows:]

PREPARED STATEMENT OF HON. PAUL RYAN, CHAIRMAN, COMMITTEE ON THE BUDGET

Welcome all to the House Budget Committee.

The purpose of today's hearing is to examine the need to restore responsibility and accountability to how Washington spends taxpayers' hard-earned dollars.

The breakdown of responsible budgeting is clear: out-of-control government spending; four consecutive trillion-dollar deficits; and a crushing burden of debt in the years ahead.

Both political parties share in the blame for our fiscal mess.

I believe it will require both political parties to work together to find common ground and right this fiscal ship.

Unfortunately, the current leaders in the Democrat-controlled Senate and at the White House have failed to step forward with solutions that match the magnitude of our challenges.

The United States Senate has failed to pass a budget in over three years. They didn't even propose a budget this year or last. And the President has punted on the key economic and fiscal challenges of our time—with budgets calling for even more spending, higher taxes, and empty promises that are quickly becoming broken promises.

This failure of leadership not only undermines the America our children will inherit tomorrow, but it also stifles confidence and economic growth today.

While budget process reform alone cannot solve our budget problems, we can strengthen this process and provide additional tools to help address the enormous budget problems we face.

This is a good step in the right direction, but budget process reform is not a substitute for the political courage and leadership required to address our core spending and entitlement challenges.

I don't think there is any doubt about the failure of the federal budget process, but there are big differences of opinion on how to tackle these challenges.

Despite these differences, the ranking member and I were able to work—on a bipartisan basis—to report out of this committee and pass on the floor the Expedited Legislative Line-Item Veto and Rescissions Act.

This Committee has also advanced the Baseline Reform Act, the Budget and Accounting Transparency Act, and the Pro-Growth Budgeting Act. Today, we continue the committee's efforts to bring greater transparency to the budget process.

Mandatory spending—or autopilot spending—accounts for 60 percent of the federal budget. Through the Budget Control Act passed last summer, Congress has established statutory limits on discretionary spending with enforceable spending caps.

Implementing similar statutory controls on mandatory spending will help ensure the federal government can deliver on its promises—with sustainable entitlement programs and a sustainable fiscal future. To that end, Committee member John Campbell of California has introduced the Spending Control Act.

Another criticism of the budget process is the failure to account for the future consequences of today's decisions.

As we develop the budget and consider legislation, we currently focus solely on the 10-year window, not taking into account the long-term impact of current programs or proposed legislation.

This sole focus on the10-year window can also lead to accounting gimmicks that perversely worsen our long-term budget problems.

We must improve the way Congress budgets in the long-term and better assess the long-term implications of its policies.

Mr. Mulvaney has introduced legislation to get the federal government to budget for the long-term and Mr. Chaffetz has introduced a bill to bring greater scrutiny to federal spending.

In addition to these bills, Ms. Black has introduced legislation to give the budget the force of law, Mr. Ribble would reform the process to move to a biennial cycle, and Mr. Lankford would remove the threat of government shutdowns.

So, just the members of this committee have put forward a robust set of proposals to reform and strengthen the budget process.

To help further advance this budget process reform conversation, we welcome three terrific witnesses to the committee today.

Doug Holtz-Eakin—a former CBO director, the current president of the American Action Forum, and an expert on the budget—is back with us today.

Alison Fraser is the Director of the Thomas A. Roe Institute for Economic Policy Studies at the Heritage Foundation.

And Henry Aaron is a Senior Fellow of Economic Studies at the Brooking Institution.

All three bring expertise to inform this conversation. Thanks all of you for joining us today.

With that, I yield to the Ranking Member, Mr. Van Hollen.

Chairman RYAN. And with that, I would like to yield to the ranking member, Mr. Van Hollen.

Mr. VAN HOLLEN. Thank you very much, Mr. Chairman. I want to join the chairman in welcoming all our witnesses today as we explore ways to improve the budget process. I do hope that the Senate will take up the bill we passed over here in a bipartisan basis with respect to expedited rescission and legislative line item veto.

We all agree that we have a budget challenge and a deficit and debt challenge, especially over the long term, and we agree that we need to fix it. But I think we also agree that the fundamental problem is not the budget process rules. And no bill that simply changes the budget process rules is going to solve the underlying issue. There is no substitute for making the tough policy issues to reduce the deficit in a balanced credible way. And once the President and the Congress develop a consensus on the policies on a budget agreement then the policy process reforms can be an effective tool for enforcing its implementation, at least at the margins. First you need to deal with the fundamental policy questions.

Over the last 2 years, many serious bipartisan groups have met to examine ways to put our budget back on a path towards balance. Each of these groups has agreed that we need to take a balanced approach toward deficit reduction that involves a combination of spending cuts and cuts to—and revenues generated by eliminating tax breaks that are unproductive in many cases in the economy.

Unfortunately our Republican colleagues continue to oppose the balanced approach. Again, 98 percent of our Republican colleagues in the House have signed a pledge that says they will not close a single corporate tax loophole for the purpose of deficit reduction and won't ask people making more than a million dollars a year to contribute one penny more for the purpose of deficit reduction. That, of course, leaves only very deep cuts in spending that help everybody else rather than a balanced approach asks for shared responsibility. And in an era of divided government, we need to be able to make the difficult compromises necessary to get the job done. Unfortunately in some parts of this House, compromise has become a dirty word.

Today's hearing is designed to examine a number of bills put forth by our Republican colleagues. Two of them deal with different forms of spending caps. Effectively what these bills do is to try and enshrine in the law the House Republican budget, the unbalanced approach to the budget with all the requirements that it would make in terms of cuts ending the Medicare guarantee and other very deep cuts and important national investments.

Interestingly, if you actually passed the bills that have been introduced with respect to the ceiling, they wouldn't even pass muster—the current fiscal year 2013 budget put forward by Republican colleagues wouldn't meet the test. It would require an automatic sequester under the bills that have been submitted.

Moreover, and I think it is an issue that every member should focus on, the effect of these bills would be to take any future economic downturn and risk turning it into a full-fledged recession or depression. And we will get into a couple of examples of how it would do exactly that and very interested in our witnesses views on that, because you have to anticipate these kind of events and the bills don't. They just take a very rigid approach.

As Mr. Holtz-Eakin observed in testimony when he was the head of the CBO speaking about an earlier Deficit Control Act, and I quote, "The target set under the Deficit Control Act, both the original ones and the revised ones were unrealistic in light of the prevailing economic conditions. For that reason and others, actual deficits remained above the targets during the years that the law was in effect." There is likely, if we don't make the tough underlying policy decisions that is the likely result here.

As Peter Orszag recently observed in a Bloomberg column, all these things are a super version of SGR, right? We thought we were going to solve rising health care costs by putting in effect SGR cuts. Every year, this Congress on a bipartisan basis has found a way around it. Doing a super-sized version of SGR is not a way to resolve our issues.

And finally, Mr. Chairman, I just want to say a word about sort of the Speaker's latest version of the mother of all sequesters, his threat that the United States would not meet its financial obligations. That, of course, would have the effect of immediate deep across-the-board cuts, but it would do so in a way that would devastate the economy. And even talking about the United States for the first time in its history not meeting its obligations is a reckless approach to economic policy and jobs.

So that is kind of a sequester on steroids, these others are different versions of that. None of them meets the test of making the tough policy decisions. So I will end with this, Mr. Chairman: These bills, in their current form, are either very dangerous to our economy if they were actually to be put into effect and followed because of the fact that they would make much worse any economic downturn, or, at best, they are misleading because they create a sense that the Congress has done something, people go home and they say to their constituents and say we passed a cap on spending, don't worry about it, knowing full well that they won't be met.

I don't know which of those consequences are worse. Although I would hate to see another full-fledged economy downturn compounded by bad policies in these bills. Thank you, Mr. Chairman.

[The prepared statement of Mr. Van Hollen follows:]

PREPARED STATEMENT OF HON. CHRIS VAN HOLLEN, RANKING MINORITY MEMBER, COMMITTEE ON THE BUDGET

Thank you, Mr. Chairman. I welcome the opportunity to explore ways that we might be able to improve the budget process. I do hope that the Senate will take up the bill that we passed over here, on a bipartisan basis, with respect to expedited rescission and the legislative line item veto.

We all agree that we have a budget challenge, and a deficit and debt challenge—especially over the long term. And we agree that we need to fix it. But I think that we also agree that the fundamental problem is not the existing budget process rules—and no bill that simply changes the budget process rules is going to solve the underlying issue. There is no substitute for making the tough policy decisions to reduce the deficit in a balanced, credible way. And once the President and the Congress develop a consensus on the policies of a budget agreement, then the policy process reforms can be an effective tool in enforcing its implementation—at least at the margins. But first you need to deal with the fundamental policy questions.

Over the last two years, many serious bipartisan groups have met to examine ways to put our budget back on the path towards balance. Each one of these groups has agreed that we need to take a balanced approach toward deficit reduction that involves a combination of spending cuts and revenues generated by eliminating tax breaks that are unproductive, in many cases, in the economy. Unfortunately, our Republican colleagues continue to oppose that balanced approach. Again, 98 percent of our Republican colleagues in the House have signed a pledge that says that they will not close a single corporate tax loophole for the purpose of deficit reduction, and they won't ask people making more than $1 million a year to contribute one penny more for the purpose of deficit reduction. That of course leaves only very deep cuts in spending that hits everybody else rather than a balanced approach that asks for shared responsibility. In an era of divided government, we need to be able to make the difficult compromises necessary to get the job done. Unfortunately, in some parts of this House, compromise has become a dirty word.

Today's hearing is designed to examine a number of bills put forth by our Republican Committee colleagues. Two of them deal with different forms of spending caps. Effectively, what these bills do is try to enshrine into law the House Republican budget, the unbalanced approach to the budget with all of the requirements that it would make in terms of cuts—ending the Medicare guarantee, and other very deep cuts in important national investments. Interestingly, if you actually passed the bills that have been introduced, the current FY2013 budget put forward by our Republican colleagues would fail to comply with the spending caps. The bills would require automatic sequester cuts of over $70 billion to the proposed FY2013 Republican budget.

Moreover, and I think this is an issue that every Member should focus on, the effect of these bills would be to take any future economic downturn and risk turning it into a full-fledge recession or depression. We will get into a couple of examples of how it would do exactly that, and I am very interested in our witnesses' views on that. Because you have to anticipate these kinds of events, and the bills do not—they take a very rigid approach.

As Mr. Holtz-Eakin observed in this testimony when he was head of the CBO, speaking about an earlier Deficit Control Act, "the targets set under the Deficit Control Act, both the original ones and the revised ones, were unrealistic in the light of the prevailing economic conditions. For that reason and others, actual deficits remained above the targets during the years that the law was in effect." And it is likely that if we don't make the underlying policy decisions—then that is the likely result here.

As Peter Orszag pointed out in his Bloomberg column, all these things are a super version of SGR. We thought we were going to solve rising health care costs by putting into effect SGR cuts. Every year Congress, on a bipartisan basis, has found a way around it. Doing a super-sized version of SGR is not a way to resolve our budget challenges.

And finally, Mr. Chairman, I just want to say a word about the Speaker's version of the mother of all sequesters—his threat that the United States would not meet its financial obligations. That, of course, would have the effect of immediate, deeper across-the-board cuts—but it would do so in a way that would devastate the economy. And even talking about the United States, for the first time in its history, not meeting its obligations is a reckless approach to economic policy and jobs.

So, that is a sequester on steroids, and these others are versions of that, and none of them meets the test of making tough policy decisions.

I will end with this, Mr. Chairman, these bills in their current form are either very dangerous to our economy if they were actually to be put into effect and followed because of the fact that they would make worse any economic downturn. Or, at best, they're misleading because they create a sense that the Congress has done something. People go home and they say to their constituents, hey, we passed a cap on spending, don't worry about it, knowing full well that the spending targets won't be met. I don't know which of those consequences is worse, although I would hate to see another full-fledged economic downturn compounded by the mindless sequesters in these bills.

Chairman RYAN. Sure. Obviously we see things differently.

Mr. VAN HOLLEN. Talk about the math, the math.

Chairman RYAN. So as we mention in my opening statement, it is not a substitute for getting the right policies, it is an enforcement for making sure that the right policy changes stick. But with that, I think we will start with Ms. Fraser and then we will go to Dr. Holtz-Eakin and Dr. Aaron.

STATEMENTS OF ALISON ACOSTA FRASER, DIRECTOR, THOMAS A. ROE INSTITUTE FOR ECONOMIC POLICY STUDIES, THE HERITAGE FOUNDATION; DOUGLAS HOLTZ–EAKIN, PRESIDENT, AMERICAN ACTION FORUM; AND HENRY J. AARON, SENIOR FELLOW, ECONOMIC STUDIES, THE BROOKINGS INSTITUTION

STATEMENT OF ALISON ACOSTA FRASER

Ms. FRASER. Thank you very much. My name is Alison Fraser, and I am the director of the Roe Institute for Economic Policy Studies at The Heritage Foundation. And the views that I will express today in my testimony are my own and shouldn't be construed as representing any official position of The Heritage Foundation. There is my disclaimer.

Thank you very much for having me here to testify before you today at this hearing today. I will tell you what you already know, which is that congressional and executive oversight of the Federal budget are in turmoil. The political aversions to toppling Federal overspending, I believe, is enhanced an enabled by the inadequate processes that govern the Federal budget. I think two things are needed to prevent a European-style fiscal and debt crisis. One, our process changes that would require some would say enforce the solution and ensure fiscal results are achieved, and, of course, the robust policies solutions themselves. Today's hearing on process reform following the House's budget resolution which contains these robust policy visions is in my view particularly welcome.

The sad fact is that U.S. Federal debt will soon reach economically damaging levels and spending will be the driver of that. The big elements of the spending growth stem from the Big Three entitlements, Social Security, Medicare and Medicaid. They compromise approximately 45 percent of the budget today, but, as we know, they will experience very fast growth in the future. A variety of projections show that it is highly possible, even likely, that the U.S. could experience a U.S.—a European style spending and debt crisis.

The problem is that changing courses seems elusive. The process which governs the Federal budget has significant weaknesses and must be addressed as both an impetus and tool to driving the necessary changes to the budget. In my view, one major gap in the budget process today is that mandatory spending is in no way budgeted. Thus the Big Three entitlement programs which essentially enjoy open-ended appropriations are allowed to grow on budgetary autopilot. Or put another way, the biggest drivers of the Federal budget are able to enjoy sort of an automatic first call on tax revenues. The problem being then that they squeeze out other priorities, whether they are low taxes, strong defense, education funding or antipoverty spending.

Another major gap is the seemingly arbitrary timeline of budget window. One-year estimates, of course, are necessary and longer term are as well, but from a budget perspective, there is nothing crucial or magical about 5 or 10 years. Neither adequately measures whether policies are affordable or as sustainable over a longer term time horizon. And indeed, these fixed, shorter-termed time frames even incentivize gaming the timing of new policies so they seem to stick within their budgetary targets and appear affordable.

Bringing entitlements in a sense on budget is an important change in both the Spending Control Act and BOLT Act. Reviewing the budget over the longer time as in the BOLT Act is equally important.

To be sure, there are tremendous challenges with making long-term budget projections. First of all, they all require a variety of assumptions which, together or alone, over the long-term, will all be wrong. But it is vital to know the direction of the budget into the future and whether, based on today's knowledge, policies are both sustainable and affordable. Projections of this nature have been made regularly over the years by a number of departments, including the Congressional Budget Office. They are a good road markers of the direction that we are in. So the transparency sections of the BOLT Act featuring sustainability reports and regular review of long-term spending to me are particularly important as is the long-term reconciliation feature.

I do worry that enforcing spending caps through sequestration against long-term projections could be problematic. So a couple of possible solutions would be to include some sort of margin of error for triggering sequestration itself, and/or a slower phase in to bring spending in line with the long-term caps. As for enforcement itself, there are very understandable reasons for excluding Social Security, but the program is, in fact, already running permanent deficits. The only way for Congress to ensure spending is sustainable is to put all programs in some way on budget, even those that are the most sacrosanct, such as Social Security.

So in conclusion, the nature of the political process together has tremendous inertia to ignore our severe spending and debt problems until forced to by outside events. The objective of these bills are sound and sorely needed, I feel, to fix the budget process in order to provide more transparency, strong spending controls across the entire Federal budget, not just a small share, that provides that spending is sustainable over the long-term and to require steps for reining in spending to meet controls.

In the end, only Congress will decide if and how it will act. But I believe it is better to do so in an intentional prudent way as these bills would provide rather than in a crisis. Thank you, and I look forward to your questions.

Chairman RYAN. Thank you.

[The prepared statement of Ms. Fraser follows:]

PREPARED STATEMENT OF ALISON ACOSTA FRASER, DIRECTOR, THOMAS A. ROE INSTITUTE FOR ECONOMIC POLICY STUDIES, THE HERITAGE FOUNDATION

My name is Alison Acosta Fraser. I am the Director of the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation. The views I express in this testimony are my own, and should not be construed as representing any official position of The Heritage Foundation.

Congressional and executive oversight of the federal budget are in turmoil. The political aversion to tackling federal overspending is enhanced and enabled by the inadequate processes that govern the budget. The last time a concurrent budget resolution was passed on time was April 11, 2003. The Senate's record for failing to pass a budget resolution is even more discouraging. The budget process is especially inadequate for addressing and managing the long-term affordability and sustainability of fiscal policy. Indeed, much about the process serves to incentivize the avoidance of our long-term problems if not to exacerbate them. The biggest drivers of long-term spending—entitlements—are not subject to annual or even regular budget review and they continue sharp growth under budgetary "auto-pilot." And there are other problems with the budget process: from the way the budget window can be gamed to the exploitation of emergency spending.

Two things are needed to prevent a European-style fiscal and debt crisis: process changes which require—some would say force—solutions and ensure fiscal results are achieved, and the robust policy solutions themselves. Today's hearing on process reform is particularly welcome.

NEED FOR ACTION

Today, federal spending is at about 23 percent of GDP and debt held by the public is approximately 70 percent. When compared to the historical, post—World War II average of approximately 20 percent of GDP for federal spending and 44 percent for debt held by the public, this growth alone would be cause for concern. But the sad fact is that U.S. federal debt soon will explode to economically damaging levels and spending will be the primary driver of that explosion.

Economic growth is materially slowed when debt approaches the size of the economy. But in a world like today's, where the global economy is increasingly interconnected and global capital markets in particular, it is possible that even this can miss the true potential magnitude of a debt and spending driven crisis. There is no better evidence than to watch the European budget and debt crises continue to unfold.

By the end of the decade, debt held by the public will reach 100 percent of GDP. After a generation it will reach nearly 200 percent[1] and continue to skyrocket thereafter. The driver of this debt is federal spending; in 10 years federal spending will be at 22.1 percent of GDP, while revenues will reach 18.3 percent of GDP, essentially at their historical average of 18.1 percent.[2] Then the situation deteriorates dramatically. By 2035, spending will reach 34 percent of GDP, driven primarily by the three major entitlement programs: Social Security, Medicare, and Medicaid. In 2012, they comprise approximately 45 percent of total federal spending, or 10 percent of GDP, and by 2035 they will reach approximately 16.5 percent of GDP. Left alone, they will devour all tax revenues by 2045, assuming the historical level of taxation.

TAKING BACK OUR FISCAL FUTURE

Many budget experts on the right and left have been rightly concerned about our grave situation and the lack of substantive legislative progress. One such project, Taking Back our Fiscal Future, stemmed from a joint project of the Brookings Institution and the Heritage Foundation. Experts from those and five other organizations across the ideological spectrum worked together for over a year to "define the dimensions and consequences of the looming federal budget problem, examine alternative solutions, and reach agreement on what should be done. Despite our diverse philosophies and political leanings, we have found solid common ground." [3]

FIXING THE PROCESS

Process reform legislation should include tools to address the major gaps that exist today, controlling the growth in spending—including entitlement spending—over the both short term and the long term.

My testimony will focus on the first two of the three bills under discussion today:

• Spending Control Act, H.R. 3576, which would put enforceable limits on federal spending over the 10-year budget window, which would be enforced through sequestration;

• Balancing our Obligations for the Long Term (BOLT) Act, H.R. 3580, which would focus on the long-term budget picture by putting budget controls on total federal spending over a 30-year period, increase disclosure of the true long-term budget picture to Members of Congress and the public; and

[1] Congressional Budget Office, 2011 Long-Term Budget Outlook, Alternative Fiscal Scenario, June 2011 at *http://www.cbo.gov/sites/default/files/cbofiles/attachments/06-21-Long-Term—Budget—Outlook.pdf*.

[2] *http://www.heritage.org/federalbudget/runaway-spending-tax-revenue*. There are different ways to calculate average historic levels of revenue, spending, and debt. Such averages vary due to the time periods covered. In the Heritage Foundation's Federal Budget in Pictures publication, these averages span 50 years (1959—2008), encompassing post—World War II and pre—Great Recession years. *www.heritage.org/federalbudget*

[3] Joseph Antos, Robert Bixby, Stuart Butler, et al., "Taking Back our Fiscal Future," Brookings Institution and Heritage Foundation, April 2008, *http://www.brookings.edu/?/media/research/files/papers/2008/4/fiscal%20future/04—fiscal—future.pdf* (accessed May 30, 2012).

• Review Every Dollar (RED) Act, H.R. 3579, which would make it more feasible to control spending by creating reserve accounts for deficit reduction and placing new limits on administrative actions which can drive up spending on mandatory programs.

The Spending Control Act starts by tightening the discretionary caps in the Budget Control Act (BCA), and importantly gives more discretion to Congress to set budget priorities between security and non-security spending. Both of these are important; the BCA's total of $2.1 trillion was only a first step toward slowing the growth in spending, and more should be done. Indeed, the size of cuts taken in isolation sounds impressive, yet over the 10-year period covered by the BCA, these cuts represent merely 4.7 percent of total spending and just over half of the new debt projected over the same period. As noted earlier, reforms to the budget process must be accompanied by policy changes. The new spending caps in the Act are taken from the House-passed budget resolution, which included policy recommendations to committees, which effectively links process to the policy goals and strengthens the budget resolution. Congress should, however, have the discretion to set priorities across the entire budget, so removing the firewall between security and non-security spending is sound policy.

One major gap in the budget process today is that direct (or mandatory) spending is not budgeted. Thus, the big three entitlement programs—which enjoy essentially open-ended appropriations—are allowed to grow on auto-pilot. Put another way, the biggest drivers of the federal budget are able to enjoy an automatic "first call" on tax revenues, squeezing other priorities—be they strong defense or education. This is remarkable in the sense that affording such a budget priority to any program—much less such a major one—effectively limits congressional debate on setting national priorities. This is especially problematic for solving our spending and debt crises as it places more budget emphasis on the smallest portion of the budget and diverts attention away from the biggest drivers. To address this imbalance, this legislation would cap spending on the major entitlements in two ways.

First, it places caps on three categories of direct spending: Medicare, Medicaid and other health-related spending, and all other direct spending (exempting Social Security and net interest). Here too, the caps are set to the levels in the House-passed budget resolution—further linking program modernization with the enforcement and process side of budgeting. It is unfortunate that Social Security is exempt from caps, as it is unsustainable over the decade and beyond.[4] The program is already in permanent deficits, which means it is placing a strain on the rest of the federal budget by crowding out other spending or—more likely—higher borrowing. Exempting Social Security from spending restraint will mean more years of drawing on general revenues to cover its deficits and will not require the program reforms that are sorely needed to make it solvent and sustainable. Indeed, this seems at odds with the intent of the legislation.

Even with these diverse ideological perspectives, the recommendations in this report included taking entitlement spending off budgetary auto-pilot and budgeting for the long term. This paper was published over four years ago. One striking passage in the report notes the "huge problem the candidates are not talking about" namely, "how to narrow significantly the enormous gap between projected federal spending and revenues." Fast forward four years to the 2012 election and an even worse fiscal picture. The same flaws in the budget process still exist today, but the urgency for solving the fiscal picture is even more imperative. Fixing the process is equally important.

Second, this legislation would also cap total spending, including both discretionary and direct spending, and also requires enforcement should the caps be exceeded. Putting the brakes on total spending is essential, as noted earlier, and any limits must be enforceable. Federal spending must be evaluated by the sum of its breadth; comparisons of one part of the budget or another are simply inadequate unless the budget in its entirety is measured and limited. The devil is always in the details of just how to enforce such caps. Across-the-board cuts, which are the Act's mechanism for enforcement, are the most simple to implement, especially quickly. Moreover, there is the semblance of shared sacrifice across all programs. However, they are quite a crude tool for de facto policy-setting. This is especially true for complex programs like Medicare where such a mechanism can have all manner of unintended consequences, or in the Department of Defense where it can jeopardize efficient and cost-effective management of long-term contracts. Paraphrasing Churchill,

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[4] U.S. Social Security Administration, "The 2012 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds," April 23, 2012, *http://www.socialsecurity.gov/OACT/TR/2012/index.html* (accessed April 23, 2012).

other cuts have been tried and across-the-board cuts are the worst form * * * except for all the others.

Areas for Improvement: As noted above, Social Security is exempt from the individual direct spending caps. To set policies which both meet the needs of our citizens and are affordable and sustainable, all programs across the entire federal budget should be on a level playing field, open for debate and trade-offs. This should include even the most popular or seemingly sacrosanct ones like Social Security. It too should be subject to some form of spending restraint—whether part of an individual spending cap or subject to some limit so that all federal programs are brought under some form of budget discipline and assessment. Leaving one out—no matter how integral it is in our society—paves the way for additional exemptions. As for Social Security itself, eliminating it from a cap simply delays the day of reckoning when the trust fund is finally exhausted and solutions will happen one way or another.

The policy results of budget enforcement should be as important as the fiscal ones. So, one improvement for sequestration could be to link the particular policy proposals included in the budget resolution into sequestration rather than relying on sequestration. For example, the phase-in period for moving Medicare to a premium support model could be expedited, or income adjusting for affluent seniors could be enhanced. In such a way, the policy changes to modernize these programs would be an integral part of enforcement. Similar enforcement could be done for Social Security such as phasing in a retirement age, or further income adjusting for affluent retirees.

Another concern in the legislation is the sheer number of caps it contains: discretionary spending, three individual program caps for entitlements, and a cap on total spending. In addition to this, there is a cap on deficits. This adds potentially unnecessary complexity and makes it much harder for budget and program managers to anticipate and prepare for sequestration, and conceivably could lead to more than one set of sequestration cuts in a given year. These should be addressed in future versions of the bill. Additionally, since deficits are the result of spending and revenue levels, the deficit cap would be an impractical one that—as the bill is written—would be difficult and problematic to enforce. Since deficits are specified on budget resolutions, this seems an unnecessary addition to this bill.

The Balancing Our Obligations for the Long Term (BOLT) Act has many of the same strengths of the Spending Control Act, and some of the same concerns. Its strengths lie in the steps it takes to ensure that the entire budget—and federal spending in particular—is affordable over the longer term beyond the rather arbitrary 10-year budget window. There are several reasons this is of crucial importance.

First, lawmakers and the public must know whether existing policies are affordable over both the near term and long term. In past years, the 10-year budget window would show relatively modest increases in spending and stable debt levels. However, over the longer term, spending—especially on entitlements—explodes and the debt along with it. This was the case, for example, in the last years of the George W. Bush Administration where spending growth tapered off and revenues grew with a stronger economy which lowered deficits and the debt ratio. But it was well known that this was a false sense of security as shown by the annual reports of the Medicare and Social Security Trustees and long-term budget projections by the CBO and GAO. Lawmakers still did nothing to tackle this huge problem. The lack of long-term budget measures in the budget process allowed Congress and the Administration to ignore the problem. Exclusive reliance in the budget process on shorter-term projections even seemed to incentivize huge increases in federal spending, as in the examples of the Medicare Drug Benefit or universal health care subsidies in the Affordable Care Act, the Farm Bill, or the budget busting SAFETEA-LU Transportation reauthorization.

Second, it is possible for individual programs to appear affordable, but when examined in concert with all other spending a different, troublesome picture can emerge. When the appalling condition of Social Security and Medicare is added to the growing expanse of the federal government, the true picture of federal finances is markedly worse. Alternatively, especially important today, the longer-term horizon shows the efficacy of spending reductions. Those that do not tackle entitlement programs will do very little to bring the budget in line to where it can be either affordable or sustainable. So the objective of this legislation is sound and these kinds of changes are sorely needed.

Lastly, it is possible to game legislation such that it appears to be affordable within the 10-year budget window. The two biggest examples of new programs—the Medicare drug benefit and the Affordable Care Act—both employed this gimmick. They were affordable according to the criteria established for the legislation within the 10-year window. But since each of them back-loaded their new spending, they failed the test of sustainable and affordable policy changes over longer-term measures. For example, excess costs for the Medicare Drug Benefit were estimated to approach $8 trillion over the 75-year time horizon, net present value, more than twice the debt held by the public at the time the bill was passed.

The BOLT Act addresses these flaw by first requiring reporting over a long-term budget window—an additional 30 years after the end of the 10-year budget window. Both the legislative branch, through CBO and GAO, and the executive branch through OMB and the President's own budget submission must present an analysis of the long-term budget picture and the sustainability of policy. To be sure, these kinds of projections will not be accurate and are based on numerous assumptions such as the growth in discretionary spending, needs of defense, interest rates, the size and growth of the economy, etc. However, such projections are made regularly by the departments named above which present a reasonable picture of future spending and finances for lawmakers and the public to gauge whether the budget and major policies are sustainable. This first step, disclosure of long-term sustainability in the budget process itself is important so it can be used to guide policy in the budget resolution.

The legislation imposes spending caps over a 30-year period, beginning after the 10-year budget window closes. Here, caps include the same direct spending categories as the Spending Control Act, in addition to a total spending cap. As noted earlier, budgeting only for discretionary spending covers less than half of the budget and leaves the biggest drivers of the budget out of annual budget debates. As entitlement spending will automatically grow ever larger, these programs must be brought under a formal review process, and thus extending spending caps to them will be an important part of constraining spending to affordable levels. These caps are set using the same levels of spending as the House-passed FY-2013 budget resolution, again linking policy objectives to fiscal targets.

Spending is kept under control by long-term reconciliation, a regular review of sustainability every five years. Tens of millions of Americans rely on entitlements for retirement security, so new changes to these programs should be periodic, allowing seniors to plan and react to changes. If reconciliation and regular review fail to keep spending in check, there will be sequestration. These steps are welcome improvements over today's glaring lack of long-term budgeting. The downgrading of the nation's credit ratings last summer serves as further warning that the debt is reaching unsustainable levels and must be addressed. As the long-term budget gap is exclusively driven by spending, this legislation is properly focused on spending.

As noted above, it is important to measure the costs of new legislation over the short term, but this alone is an incomplete measure as it allows gaming of the rules towards greater spending. Measuring major legislation over the long term is an important step in ensuring sustainable policy. Such formal measures would have markedly changed the debate for the Medicare Drug Benefit and the Affordable Care Act.

Improvements: While there are fewer caps than the Spending Control Act, setting targets for Medicare, Medicaid and other health, and all other excluding Social Security may set an unnecessary level of detail for budget caps—especially over the long term. It is difficult enough to forecast spending over the long run, and requiring enforcement mechanisms at such detailed levels may prove troublesome. It is valuable to assess sustainability of individual programs. So one enhancement might be to provide additional flexibility to Congress to move resources from one category to another.

The old saw that economists spend their careers explaining why their predictions are wrong has some relevance here. Long-term estimates are bound to be wrong. So giving some breathing room for the caps and sequestration in particular through a small, acceptable margin of error would still incentivize reforms and budget control if done carefully. Ensuring that entitlement programs are not whipsawed by frequent policy changes in response to the annual sustainability report are also important. There should be a balance between the tension needed for urgent steps to rein in spending and predictability for those who rely heavily on such programs.

The Spending Control Act's shortcoming of excluding Social Security also is present in the BOLT Act.

GENERAL OBSERVATIONS

If it was only rules and procedures that were needed, our severe budget challenges would likely be resolved today. Indeed, existing laws have been ignored, whether intentionally as with the Senate, from gridlock, or just plain lack of will to address these serious problems. Since the last timely concurrent budget resolution was passed (excluding FY 2013), there has only been a concurrent budget resolution in four of out eight years. Reconciliation, the process originally designed to help Congress change current law to conform revenue, spending, and debt limit levels to the policies laid out in the budget resolution, has only been used to minor effect for deficit reduction in recent years.[5]

The nature of the political process today has tremendous inertia to ignore our severe spending and debt problems until forced to by outside events. But this approach to governing is the worst way to set policy, as crisis-driven decisions are often desperate choices which will fail. The flawed concept of the Supercommittee and the equally flawed BCA sequester are good examples. Moreover, crisis-driven decisions rarely allow for public discourse, weighing the pros and cons of such changes and building support so they are accepted. Congress and the President must act with purpose and intent to solve the spending and debt challenges, yet the system is sorely inadequate to ensure that all spending over the short term and long term is both affordable and sustainable. The objectives of these bills are sound and sorely needed: to provide more transparency, strong spending controls across the entire federal budget over the short term and the long term, and to require steps for reining in spending to meet those limits. They are important steps to fixing the budget process. In the end, Congress itself will decide if it will act. Better if it does so in an intentional, prudent way rather as these bills would provide, rather than in a crisis.

Chairman RYAN. Dr. Holtz-Eakin.

STATEMENT OF DOUGLAS HOLTZ–EAKIN

Mr. HOLTZ–EAKIN. Chairman Ryan, Ranking Member Van Hollen and members of the committee.

Chairman RYAN. Pull your mic a little closer.

Mr. HOLTZ–EAKIN. Thank you again for the privilege to appear today, and I look forward to your questions. Let me briefly make a couple points at the outset. First, to echo what has already been said, the Federal budget process is fundamentally broken. At best, when it works, the President submits a budget and the House and Senate pass budget resolutions and conference it to a single agreement, but there is in fact no reason why is has to match what the President submitted, there is no reason why the amount of spending in mandatory programs has to have any relation to the discretionary programs, and there is no reason why taxes have to match spending in any fundamental way.

So when it works well, it doesn't produce a fiscal policy, it produces a fiscal outcome, and it is usually bad. At the moment, it is not working well at all. As the chairman noted, the Senate is not passing budgets at all. The President's budget submissions can't even get votes in either House of Congress. And we have a demonstrable dangerous fiscal state. As this committee is well aware, we already have gross Federal debt that exceeds the size of the U.S. economy. We have all the characteristics of countries that get into sovereign debt crises, high levels of debt, heavy reliance of short-term borrowing, a failure to understand fully the obligations that the taxpayer faces and then they pop up and we have to pay for them. All of this suggests the need for dramatic action in the United States.

The history of countries that have gotten in this situation has actually provided a road map for the right thing to do. In circumstances of bad growth and large debt, the best set of policies

[5] See Alison Acosta Fraser and Brian M Riedl, "The Deficit Reduction Act: One Small Step for the House," Heritage Foundation WebMemo No. 911, November 9, 2005, *http://www.heritage.org/research/reports/2005/11/the-deficit-reduction-act-one-small-step-for-the-house.*

are to keep taxes low and reform them to be as pro-growth as possible and to control spending. And the key in controlling spending turns out to be government employment, not a real big problem in the United States, and transfer programs. And in the United States, those transfer programs are the large mandatory spending programs, they are the entitlements, Medicare, Medicaid, Social Security and the new Affordable Care Act. So the policy playbook is actually apparent, the question is can you design a budget process which will be a complement and support that policy process. And as everyone here has noted, process is no substitute for getting policies right.

The key features of the pieces of legislation under control today, under consideration today, are that they actually put mandatory spending on a budget, and that is a necessary complement to getting policies control spending programs which are at the heart of addressing the Nation's problems, so putting mandatory spending on a budget is an enormously important step, and having a long-term outlook with mechanisms to force action to keep the policies on track is the second key feature.

There are lots of other details, but there is no substitute for doing that. These are examples of fiscal rules, imposing a set of fiscal rules on a Congress is an important step for the United States. It has been tried elsewhere around the globe, as I noted in my written testimony, the Dutch adopted its spending caps, the Swedes adopted spending caps and targets for surplus averaged over the business cycle. These kinds of fiscal rules have been shown to improve budgetary and economic performance around the globe. I applaud the attempt to consider these here and get the United States on a better track, both from a policy and process point of view, thank you.

Chairman RYAN. Thank you.

[The prepared statement of Mr. Holtz-Eakin follows:]

PREPARED STATEMENT OF DOUGLAS HOLTZ-EAKIN, PRESIDENT, AMERICAN ACTION FORUM*

Chairman Ryan, Ranking Member Van Hollen and members of the Committee, I am pleased to have the opportunity to appear today. In this testimony, I wish to make a few basic points:

- The U.S. faces a dramatic threat from the current and projected levels of federal debt, driven by ever-increasing mandatory spending;
- The outlay reductions in the president's budget proposal or the Budget Control Act are dwarfed by the scale and imminence of the problem;
- The current Congressional budget process is broken, and does not facilitate addressing the threats to the Nation;
- The legislation contemplated in this hearing have relative strengths and weaknesses, but are clearly designed to introduce greater discipline in the budgeting process;
- In particular, to the extent they involve the adoption of a "fiscal rule" these proposals would be a valuable step toward budgetary practice that would address the debt threat and preclude its recurrence; and
- Budget process reforms are commendable, and to the extent they can precipitate action, they should be pursued, but are no substitute for necessary underlying policy changes.

Let me discuss each in turn.

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*The opinions expressed herein are mine alone and do not represent the position of the American Action Forum. I thank Gordon Gray for his assistance.

THE THREAT FROM FEDERAL DEBT

The federal government faces enormous budgetary difficulties, largely due to long-term pension, health, and other spending promises coupled with recent programmatic expansions. The core, long-term issue has been outlined in successive versions of the Congressional Budget Office's (CBO's) Long-Term Budget Outlook.[1] In broad terms, the inexorable dynamics of current law will raise federal outlays from an historic norm of about 20 percent of Gross Domestic Product (GDP) to anywhere from 30 to 40 percent of GDP. Any attempt to keep taxes at their post-war norm of 18 percent of GDP will generate an unmanageable federal debt spiral.

This depiction of the federal budgetary future and its diagnosis and prescription has all remained unchanged for at least a decade. Despite this, lasting action (in the right direction) has yet to achieve the force of law.

In the past several years, the outlook has worsened significantly.

Over the next ten years, according to the Congressional Budget Office's (CBO's) analysis of the President's Budgetary Proposals for Fiscal Year 2013,[2] the deficit will average over $630 billion over the next ten years. Ten years from now, in 2022, the deficit will be 3.0 percent of GDP, roughly $700 billion. As a result of the spending binge, in 2022 debt held by the public will nearly have doubled from its 2008 level to roughly 80 percent of GDP and will continue its upward trajectory.

The "Bad News" Future under Massive Debt Accumulation. A United States fiscal crisis is now a threatening reality. It wasn't always so, even though—as noted above—the Congressional Budget Office has long published a pessimistic Long-Term Budget Outlook. Despite these gloomy forecasts, nobody seemed to care. Bond markets were quiescent. Voters were indifferent. And politicians were positively in denial that the "spend now, worry later" era would ever end.

Those days have passed. Now Greece, Italy, Portugal, Spain, Ireland, and even Britain are under the scrutiny of skeptical financial markets. And there are signs that the U.S. is next—as witnessed by the decision of S&P to downgrade the federal credit rating. The federal government ran a fiscal 2011 deficit of $1.3 trillion—nearly 9 percent of GDP, as spending remained above 24 percent of GDP and receipts remained below 16 percent of GDP.

How did this happen? First, the U.S. frittered away its time for easier action. It was widely recognized that the crunch would only arrive when the baby boomers began to retire. Guess what? The very first official baby boomer already chose to retire early at age 62, and the number of retirees will rise as the years progress. Crunch time has arrived and nothing was done in the interim to solve the basic spending problem—indeed the passage of the Medicare prescription drug bill in 2003 made it worse.

Second, the events of the financial crisis and recession used up the federal government's cushion. In 2008, debt outstanding was only 40 percent of GDP. Already it is approaching 70 percent and rising rapidly.

Third, active steps continue to make the problem worse. The Affordable Care Act "reform" added two new entitlement programs for insurance subsidies and long-term care insurance without fixing the existing problems in Social Security, Medicare, and Medicaid.

Financial markets no longer can comfort themselves with the fact that the United States has time and flexibility to get its fiscal act together. Time passed, wiggle room vanished, and the only actions taken thus far have made matters worse.

As noted above, in 2022 public debt will have nearly doubled from its 2008 level to nearly 80 percent of GDP and will continue its upward trajectory. Already, gross federal debt exceeds 100 percent of GDP. Using this measure, research shows that a debt-to-GDP ratio of 90 percent or more is associated with the risk of a sovereign debt crisis.

Perhaps even more troubling, much of this borrowing comes from international lending sources, including sovereign lenders like China that do not share our core values. Rather than reducing this threat, according to news reports the United States is facilitating increased indebtedness to China by providing the People's Bank direct access to Treasury markets.[3]

For Main Street America, the "bad news" version of the fiscal crisis occurs when international lenders revolt over the outlook for debt and cut off U.S. access to international credit. In an eerie reprise of the recent financial crisis, the credit freeze

[1] Congressional Budget Office. 2011. The Long-Term Budget Outlook. Pub. No. 4277. *http://www.cbo.gov/ftpdocs/122xx/doc12212/06-21-Long-Term—Budget—Outlook.pdf*

[2] Congressional Budget Office. 2012. An Analysis of the President's 2013 Budget. *http://www.cbo.gov/sites/default/files/cbofiles/attachments/03-16-APB1.pdf*

[3] Flitter, Emily. Reuters. *http://www.reuters.com/article/2012/05/21/us-usa-treasuries-china-idUSBRE84K11720120521*

would drag down business activity and household spending. The resulting deep recession would be exacerbated by the inability of the federal government's automatic stabilizers—unemployment insurance, lower taxes, etc.—to operate freely.

Worse, the crisis would arrive without the U.S. having fixed the fundamental problems. Getting spending under control in a crisis will be much more painful than a thoughtful, pro-active approach. In a crisis, there will be a greater pressure to resort to damaging tax increases. The upshot will be a threat to the ability of the United States to bequeath to future generations a standard of living greater than experienced at the present.

Future generations will find their freedoms diminished as well. The ability of the United States to project its values around the globe is fundamentally dependent upon its large, robust economy. Its diminished state will have security repercussions, as will the need to negotiate with less-than-friendly international lenders.

The "Good News" Future under Massive Debt Accumulation. Some will argue that it is unrealistic to anticipate a cataclysmic financial market upheaval for the United States. Perhaps so. But an alternative future that simply skirts the major crisis would likely entail piecemeal revenue increases and spending cuts—just enough to keep an explosion from occurring. Under this "good news" version, the debt would continue to edge northward—perhaps at times slowed by modest and ineffectual "reforms"—and borrowing costs in the United States would remain elevated and escalating.

Profitable innovation and investment will flow elsewhere in the global economy. As U.S. productivity growth suffers, wage growth stagnates, and standards of living stall. The combination of sluggish income growth and a very large tax burden from the debt, assures that the next generation will inherit a standard of living inferior to that bequeathed to this one.

THE NEED FOR ACTION

The federal budget problem demands fundamental reforms to major mandatory spending programs—Medicare, Medicaid, Social Security, the Affordable Care Act—and would benefit from the improved growth derived from fundamental tax reform. Despite this, successive budget proposals by the president are devoid of reform proposals and characterized at best by the type of piecemeal spending cuts and tax increases that invite stagnation.

Recently, the passage of the Budget Control Act of 2011, its caps on discretionary spending, and the formation of the Joint Select Committee on Deficit Reduction represented a commitment to move the nation's finances in a better direction.

However, the failure of the Committee to report recommendations to address our fiscal challenges has left the United States in a perilous position. It faces the expiration of tax polices most recently extended in 2010 and a sequester that is widely judged to be bad policy. The combined effect of these policies, in an unprecedented statement from CBO, threatens recession.[4]

However, the structural budget challenges the nation faces are so pressing and significant that they outweigh in terms of their implications for economic output even a near-term recession. Clearly something must be done to avoid a downturn, but any such undertaking must be paired with reforms to address our fiscal imbalance.

THE BROKEN BUDGET PROCESS

The Congressional budget process is broken and does not engender regular evaluation of the fiscal health of the federal government. Indeed, the prima facie evidence of its failure is that fact that the president has regularly submitted budgets that clearly display a path to a sovereign debt crisis, the U.S. Senate has not adopted a budget resolution in three years, and the Congress as a whole regularly operates without a binding budget resolution—all with no consequence.

The budget process is intended to facilitate a regular and disciplined evaluation of the inflow of taxpayer resources and outflow of federal spending. It should enhance the role of the Congress as a good steward of the federal credit rating. It does neither because the current process is insufficiently binding. As a result, it easily degenerates to the mere adoption of current-year discretionary spending levels, with no review of the real problem: the long-term commitments in mandatory spending.

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[4] Congressional Budget Office. 2012. Economic Effects of Reducing the Fiscal Restraint That Is Scheduled to Occur in 2013. *http://www.cbo.gov/sites/default/files/cbofiles/attachments/FiscalRestraint—0.pdf*

LEGISLATIVE PROPOSALS FOR PROCESS REFORM

To the extent that process reforms introduce added discipline to governance, and contribute to good budgetary outcomes, they should be commended. I believe there are elements of each of the three bills considered today that meet that test.

BALANCING OUR OBLIGATIONS FOR THE LONG TERM ACT OF 2011

As noted above, the U.S. long-term budget challenge is daunting—now more so because what was once a truly long-term challenge now confronts in the medium term. Indeed, if credit markets observe a continued failure to put in place a credible plan to address this challenge, there would likely be near-term implications.

The BOLT Act should be viewed favorably for its focus beyond the standard budget window. Any meaningful reform to major entitlements may have only modest impact within the 10 year budget window, but are the only sort of reforms that will address our looming, spending-driven debt crisis. Some efforts on this issue have been made in the past, such as the long-term budget point of order, the codification of which is a particularly laudable aspect of this legislation. Strengthening of the "Medicare trigger" enacted in 2003, but repeatedly ignored by the current administration is also a worthy pursuit.

I must also note with caution the reliance inherent in this legislation on long-term budget projections. Any budget process that is contingent upon a long-term estimate of federal finances and a subsequent long-term estimate on how legislation (the compulsory "fast-track" legislation) might alter those finances is fraught with uncertainty. It is simply beyond the scientific capabilities of the budget community to project these impacts with great certainty. The need for Congress to consider the long-term outlook is undeniable. Assuring that federal finances are sustainable and that the debt trajectory is downward are far more important than hitting precise projected numerical targets.

SPENDING CONTROL ACT OF 2011

Any serious approach to budget discipline must include mandatory spending, which comprises over half of federal spending. The Budget Control Act, and other efforts, principally stemming from this body have put the brakes on discretionary spending growth. I would commend any policymaker for rooting out additional savings in discretionary programs, in domestic and defense appropriations, but much of the low-hanging fruit has been culled, and undue effort to squeeze less consequential savings from discretionary programs at the expense of a much needed debate on entitlement reforms would likely be unproductive. While praise-worthy for staunching the recent discretionary spending binge, the Budget Control Act, in its post Super Committee-failure guise, suffers from this flaw.

The Spending Control Act addresses this flaw by introducing measures to restrain direct spending, overall spending, and deficits. I believe the inclusion of mandatory spending into any budget process reform regime is critical. While ultimately, we must reform the underlying elements of mandatory programs, the desire to establish a global budget for mandatory spending, which is essentially what such a cap would do, is well intentioned, and would advance the goal of imposing needed reforms to these programs.

REVIEW EVERY DOLLAR ACT OF 2011

Much like the previous two proposals, this legislation addresses the critical driver of our budget woes—direct spending. A periodic reassessment, as called for in the Review Every Dollar Act, of all federal programs should serve as a catalyst for the necessary debate on how to address our mandatory programs. That is the crucial first step to reining in the largest and fastest growing federal programs.

The RED Act also seeks to address other specific flaws in current budget practice that are worthwhile efforts. Making explicit the tens of billions in federal transfers to the Highway Trust Fund is critical to effectively prioritizing federal spending initiatives. In a time of tight budgets, prioritization must determine funding allocations, and if we are to do so with any fidelity, then the masking of the state of the Trust Fund's finances is a practice that must come to an end. Additional measures in the RED are also commendable for their approaches to other such anomalies that impede proper budgetary practice.

THE VALUE OF FISCAL RULES

One way to think of the reforms under consideration today is in the context of a federal "fiscal rule." At present, the federal government does not have a fiscal "policy." Instead, it has fiscal "outcomes". The House and Senate do not reliably agree on a budget resolution. Annual appropriations reflect the contemporaneous politics of conference committee compromise, and White House negotiation. Often, the annual appropriations process is in whole or part replaced with a continuing resolution. Annual discretionary spending is not coordinated in any way with the outlays from mandatory spending programs operating on autopilot. And nothing annually constrains overall spending to have any relationship to the fees and tax receipts flowing into the U.S. Treasury. The fiscal outcome is whatever it turns out to be—usually bad—and certainly not a policy choice.

I believe that it would be tremendously valuable for the federal government to adopt a fiscal rule. Such a rule could take the form of an overall cap on federal spending (perhaps as a share of gross domestic product (GDP)), a limit on the ratio of federal debt in the hands of the public relative to GDP, a balanced budget requirement, or many others. Committing to a fiscal rule would force the current, disjointed appropriations, mandatory spending, and tax decisions to fit coherently within the adopted fiscal rule. Accordingly, it would force lawmakers to make tough tradeoffs, especially across categories of spending.

Most importantly, it would give Congress a way to say "no." Spending proposals would not simply have to be good ideas. They would have to be good enough to merit cutting other spending programs or using taxes to dragoon resources from the private sector. Congress would more easily be able to say, "not good enough, sorry."

As documented by the Pew-Peterson Commission on Budget Reform[5] other countries have benefitted from adopting fiscal rules. The Dutch government established separate caps on expenditures for health care, social security and the labor market. There are also sub-caps within the core sectors.

Sweden reacted to a recession and fiscal crisis by adopting an expenditure ceiling and a target for the overall government surplus (averaged over the business cycle). Later (in 2000) a balanced budget requirement was introduced for local governments. Finally, in 2003 the public supported a constitutional amendment to limit annual federal government spending to avoid perennial deficits.

A lesson is that, no matter which rule is adopted, it will rise or fall based on political will to institute it and the public's support for its consequences.

NECESSARY POLITICAL WILL

All three of the measures being discussed today share the necessary goal of controlling the largest drivers of our spending problem. To the extent that the three bills before the Committee impel reforms to our entitlement programs, then I support their passage. However, process reform, no matter how well intentioned or considered is no substitute for the actual reforms needed to address the looming debt crisis fueled by federal spending. No statutory spending cap or scheduled sequester can replace the needed debate on what a realistic or fair retirement age should be, or what the proper federal role in seniors' health care delivery is. So while I commend the authors of the legislation we are discussing, I would also caution this Committee's membership, as many know, the clock is ticking on the need for that broader discussion.

Thank you. I look forward to your questions.

Chairman RYAN. Dr. Aaron.

STATEMENT OF HENRY J. AARON

Mr. AARON. Thank you very much, and I am very glad to be here. I would like to begin with some areas of agreement.

Chairman RYAN. Pull your mic a little closer.

Mr. AARON. Sure. I would like to begin with some areas of agreement. There is not a hair's worth of difference among us on the issue of the importance of dealing with the long-term budget challenge that we face. There is not much difference among us on the question of whether budget procedures could, in fact, be improved. This hearing, however, isn't about those issues; it is about whether these particular bills are the right way to go about dealing with those problems.

The second area of agreement, I think among us, both Ms. Fraser and Mr. Holtz-Eakin emphasized in their testimony the problem-

[5] *http://budgetreform.org/*

atic nature of any rule that is linked to very long-term projections because they are wrong and exact, and if they force actions, they are subject to random and capricious errors, and they actually place in the hands of technocrats decisions that properly belong in the hands of Congress.

A third area, one that Ms. Fraser emphasized, is that these bills contain way too many caps and are unbalanced because they omit from their ambit consideration of revenues as part of the fiscal picture.

Mr. Holtz-Eakin just mentioned an aspect of his testimony that I wanted to also emphasize, which is his reference to budget caps in European countries. I would like to go on record, maybe bragging a bit, I suggested precisely such a budget cap for U.S. health care spending in total 20 years ago in a Brookings volume, I still think it is a good idea but that is not what these bills do. What these bills do is single out those aspects of health care spending that benefit the aged, the disabled and the poor. In that respect, they differ fundamentally from the very European proposals to which Mr. Holtz-Eakin called attention.

I would like to echo and repeat a point that Mr. Van Hollen made in his opening remarks. I think it is important that none of us, I believe, is opposed to procedural reforms in the budget process. The current system is flawed it suffers from many of the shortcomings from which Mr. Holtz-Eakin previously referred. But there is also a very clear record of consistent and complete failure of budgetary procedural rules to take the place of substantive negotiations on the very policies that comprise the budget and are projected to cause problems in the future. They have never succeeded in the past in the United States, there is no reason to think they will do so in the future. They are no substitute for the specific substantive negotiations.

When and as those negotiations yield an agreement on how to deal with long-term budget challenges, changes in procedural rules can help cement and sustain those agreements. But to date, there is no evidence whatsoever that they can bring those agreements about.

I would like in my concluding couple of minutes to focus on what I think is perhaps the fundamental problem with the procedural rules that are contained in this bill. They call for spending cuts that, in my view, are simultaneously mistimed, wrongly calibrated, and perversely targeted. They are mistimed because they would be triggered just when additional spending is needed to counter weakness in private demand. They are wrongly calibrated because they would be largest during the deepest recessions when those expenditures are most needed, and they would be perversely targeted because they would fall most heavily on the jobless and the sick precisely at the time when assistance for those groups is most sorely needed.

I want to conclude by reiterating once again that I am not, in any way, urging opposition to procedural reforms in budget process. I think they are an important step for this committee to take a leadership role in bringing about, but they are no substitute and they cannot proceed substantive agreement on the budgetary measures necessary to improve the long-term fiscal picture of this country. Thank you.

Chairman RYAN. Thank you.

[The prepared statement of Mr. Aaron follows:]

PREPARED STATEMENT OF HENRY J. AARON, SENIOR FELLOW, ECONOMIC STUDIES, THE BROOKINGS INSTITUTION[1]

MR. CHAIRMAN AND MR. RANKING MEMBER: Thank you very much for inviting me to testify today.

These bills deal in complex ways with the rules that will govern how Congress handles budgetary matters in the near and distant future. In my testimony, I shall focus primarily on HR 3576 and 3580. I shall emphasize the following points.

- These bills would establish stringent spending limits. Those limits would force spending to be cut far below levels set in laws that Congress has duly enacted and the President has signed. These cuts would span the federal budget, cutting spending in myriad programs without debate or vote by members of Congress on the specific cuts involved.
- The limits on the size of government in HR 3576 and HR 3580 are lower than actual expenditures during the administrations of the last five presidents, Republican and Democratic. A variety of forces will tend to increase government spending in the future.
- The bills would set limits on deficits without regard to economic conditions. If adopted, they would likely deepen and lengthen recessions. They would increase unemployment and lower earnings and profits at times when the economy was already in distress.
- Although ostensibly aimed a limiting the scope of government, these bills would do nothing to curb tax provisions that are the functional equivalent of expenditures and that, like direct spending, alter the private allocation of resources.
- Although ostensibly aimed at limiting deficits, these bills would do nothing to inhibit deficit-increasing cuts in tax rates or the creation of new deductions, credits, or exclusions.
- These bills would end the established and benign principle, present in budget deals and negotiations for more than two decades and most recently embraced by the Bowles-Simpson commission, that programs protecting low income Americans should be exempt from sequestration.
- The bills would limit the size of government and fiscal policy not just for the next several years, but into a future no one can foresee. To do so, they must depend on projections of economic and political circumstances that are subject to vast uncertainty and enormous discretion by those preparing projections. They thereby cede to unelected technicians, who must use opaque assumptions and procedures, power over policies that under the Constitution are the responsibilities of members of Congress.

Government spending, revenues, and the deficit change because of new legislation and evolving economic circumstances. Congress enacts legislation. It does not control the economy.

Spending and revenues change automatically with economic activity. Most taxes increase when the economy expands and shrink when the economy contracts. Many expenditures vary with economic activity, as well.

- Spending under Old-Age, Survivors, and Disability Insurance, Medicare, and Unemployment Insurance increases when the economy slows. So does spending under income- or means-tested programs, such as Medicaid, Temporary Assistance to Needy Families, Supplemental Nutrition Assistance.
- Personal and corporation income taxes, payroll taxes, and many excise taxes rise and fall with economic activity.

These automatic variations in taxes and spending help keep the economy on an even keel. When the economy is booming, rising revenues and falling spending tend to prevent the economy from overheating. When the economy is declining, falling revenues and rising government spending directly support private demand or offset its fall. Without automatic stabilizers, the economy would more easily 'overheat' during economic booms. Without automatic stabilizers, the drop in income and increase in unemployment during recession would be more severe than is with them.

[1] Bruce and Virginia MacLaury Senior Fellow, the Brookings Institution. The views expressed here are my own and do not necessarily reflect those of the trustees, officers, or other staff of the Brookings Institution.

The faster such offsetting effects occur, the better. These stabilizing effects would be delayed if anti-recession legislation were enacted only after official statistics signaled economic shifts and only after Congress reacted to such news and resolved the inevitable political squabbling about just what to do. The fiscal relief measures enacted in 2008 under President George W. Bush and 2009 under President Barack Obama, for example, would have done even more good than they did if political disagreements had not delayed them.

The bills that the Budget Committee is considering today would weaken or reverse portion of the benign fiscal effect of automatic stabilizers traceable to expenditures. They would not prevent tax collections from falling during recession. But both the spending and deficit caps would prevent spending from increasing. In fact, they would force spending cuts. Those cuts would be mis-timed, wrongly calibrated, and perversely targeted.

- The spending cuts would be mis-timed because the caps would cut spending just when it should be increased—during economic slowdowns. That is when spending targeted on the unemployed and the needy automatically increases. That spending has two beneficial effects. It helps to maintain demand. And it relieves hardships associated with unemployment and falling income. Together with recession-induced drops in revenues, rising spending generates budget deficits and boosts the ratio of spending to GDP. To cut spending when the economy is weak would be no less wrong-headed than it would be to raise tax rates to offset the automatic drop in revenues. To do either because of an arbitrary formula would be folly.
- The cuts would be wrongly calibrated because they would be largest during the deepest recessions when spending is most needed. It is during deep recessions when spending unemployment compensation, pensions, and health and food benefits increases most. It is during deep recessions when such assistance is needed most.
- The cuts would be perversely targeted because they would fall most heavily on the jobless and the sick. Meanwhile, of course, the automatic stabilizer that would be left in place—tax flexibility—would go disproportionately to those who had the highest incomes and therefore faced the highest tax rates—those with high wealth or income. Please understand, the automatic reduction in tax collections that occurs when economic activity slows is a good thing. It also attenuates economic losses. But so, too, do automatic increases in government spending. To enact rules that reverse either of these automatic responses to declining economic activity would be senseless. Yet, that is just what these bills would do.

Please understand as well that this indictment of spending and deficit triggers in these bills does not depend on the wisdom or lack thereof of the particular stimulus legislation enacted at the end of President George W. Bush's administration or the separate law enacted early in President Obama's administration. I believe that this legislation was beneficial, as does the report issued this week by the Congressional Budget Office. I also think that the stimulus packages were generally well, although not ideally, designed and were too small. Some members of this Committee probably agree with those judgments. Some probably do not. But whatever one may think about the 2008 and 2009 stimulus packages should have nothing to do with one's view of the legislation on which you are holding hearings today. I speculate that few members of this Committee personally believe that it would have been a good idea to cut unemployment insurance, Medicaid, defense procurement, agricultural supports, and highway construction just when timed to take effect when the financial collapse of 2008 occurred and massive unemployment ensued. I also speculate that fewer still would have voted for such cuts. Yet, such cuts would have been forced had legislation such as proposed in these bills been enacted by those who a decade or two ago sat where you sit now.

To make matters even worse, the sequestration rule in this bill reserves the largest cuts for those programs that increase when economic activity falls or that were considered sufficiently important for Congress to expand faster than inflation. Outlays that are not expanding faster than the consumer price index would be exempt from sequesters.

Programs that rise when unemployment goes up or incomes fall will surely rise faster than consumer prices. They will be cut. Spending on programs that Congress has deemed important enough to expand will increase faster than the consumer price index. They will be cut.

What is left? Programs that don't directly help the unemployed or those with falling incomes. Programs that Congress does not think worth increasing. They will not be cut. It is hard to imagine a provision more perversely designed to slow economic recovery, to harm those most in need of help, and to shift resources from activities from high to low priority uses.

Disagreement about the proper role and size of the federal government is as old as our republic and was never deeper than it is today. These bills attempt to settle that disagreement through budgetary procedures. They create major, even insuperable, hurdles to raising spending. Simultaneously, they lower current barriers to cutting taxes.

Trying to settle the long-standing and deeply felt disagreements about the proper role and size of government in this way is a bit like trying to settle the outcome of a football game by telling one team that it has to go twenty yards for a first down and the other team that it has to go only ten. Such rules would be laughably unfair and one-sided. The same may be said of the cut-go rules.

This harsh comment in no way contradicts the importance, once the recovery is well established and well under way, of bringing the deficit under control. It also does not deny that elected officials may be tempted spend the taxpayer's money irresponsibly if they are not forced to take account of the full costs of that spending. But there is a parallel and equally serious danger that elected officials, unless forced to take account of the deficit-increasing effects of their actions, use tax cuts to pander to their constituents. You ignore either risk at the nation's peril.

It is fair and sensible to require sponsors of new spending to show how they will pay for what they want to spend. It is equally fair and sensible to require sponsors of tax cuts to show how they intend to offset the revenues they will surrender. It is neither fair nor sensible to require one, but not the other.

Nor would it be fair nor sensible for current members of Congress to presume that they are sufficiently informed or far-sighted to know what the size or scope of government should be decades hence. The fiscal records of the last five presidents have varied widely. In every year Ronald Reagan and George Herbert Walker Bush were in office, as well as three of the presidential years of Bill Clinton and of George W. Bush, budget outcomes would have failed the spending tests set in HR 3576. In every budget year of the presidencies of Ronald Reagan and George Herbert Walker Bush, in four of the budget years of Bill Clinton, and in six of the budget years of George W. Bush, the deficit tests set in that bill would have triggered sequesters.

• Budgets for each president are assumed to begin with the fiscal year after the year in which they are inaugurated and to run through the fiscal year in which their successor is inaugurated.

Hard, objective forces drove government spending and deficits during those presidencies. Similar forces will drive spending in the future. Future presidents and Congresses may find it necessary to deploy American military power abroad. They will encounter added pension costs for the tens of millions of baby-boomers yet to retire. If we are lucky, they will have to cope with added medical spending for a growing menu of beneficial diagnostic and therapeutic interventions. Unless we are both luckier and wiser than we have an reason to expect, they will have to grapple with recessions, financial panics, and natural disasters. No Congress can repeal such events. No Congress can foresee when they will happen or how severe they will be. It would therefore be profoundly unwise to legislate caps that hamstring what can then be done.

For at least two decades, deficit reduction efforts have been guided by the principle that the burden of closing the deficit should be shouldered by those with adequate incomes—the middle class and the well-to-do—not by the poor, people with disabilities, or the elderly, and certainly not primarily by these vulnerable groups. This view has been shared by Republicans and Democrats alike. Erskine Bowles and Alan Simpson endorsed this principle in the introduction to their draft plan for deficit reduction. While the overall plan did not secure the requisite super majority laid out in its charter, there has been no indication that committee members rejected this underlying principle.

Yet these bills would do just that. They would subject to sequester programs that serve the poor, such as Medicaid and Supplementary Nutrition Assistance. They would, in fact, target these programs for the largest cuts. They would permit long-term pension commitments to be rewritten without explicit debate, based on projections of spending or deficits stretching decades into the future that historically have been laughably inaccurate and are, inevitably, subject to manipulation through the artful selection of assumptions.

It is just over a decade since budget analysts, a Federal Reserve chairman, and at least a few economists worried—I am not making this up!—that then-anticipated budget surpluses would sop up all outstanding government debt and make impossible the management of monetary policy. Those worries now seem risible, but serious people believed them, just as many people now believe that projected deficits will materialize. We now see that projections thirteen years ago were unduly rosy. We should understand that it is just as easy for current projections, which depend on assumptions about events we cannot possibly anticipate, may be unduly bleak.

The Congressional Budget Office now issues long-term budget projections under alternative assumptions. Informed observers understand that these projections are highly sensitive to underlying but seldom examined assumptions. For example, if health care spending slowed to the rate of growth of income, most of currently projected long-term budget deficits would largely vanish. Let me be clear * * * I think such a slowdown in growth of health care spending is unlikely and we shouldn't count on it. But how fast health care spending rises depends sensitively on the fruits of future medical research. We can guess, but we cannot know, what will be, but has not yet been, discovered. Projections are also sensitive to assumed interest rates, labor force participation, and productivity growth. CBO is crystal clear that its long-term budget projections are not forecasts, but extrapolations of certain trends about variables that no one can forecast accurately. CBO's projections shape public debate, as they should. But they do not, and should not, trigger specific legislative action. HR 3580 would convert these guesses about the future course of spending and revenues into action forcing events and goad Congress and the President to act now on projections of spending and deficits as much as forty years in the future.

During the 1980s, the nation faced large and troubling deficits. Members of Congress repeatedly enacted rigid targets for deficit reduction. None worked. Then, presidents of both parties and Congress under both Republican and Democratic leadership dealt with the substantive cause of deficits. They identified spending that Congressional majorities agreed could be cut and taxes that could be increased.

After those agreements had been struck, but only then, the pay-go procedural rules helped members stick by the deal. But those rules applied to both taxes and spending. They did not presume to know how much government should spend or tax decades into the future. They did not foster budget policy that would deepen recessions. They protected vulnerable populations and did not force them to shoulder the burden of deficit reduction. And, until they were repealed, they worked.

Chairman RYAN. Ms. Fraser, let me start with you, I have got this piece from Brookings and Heritage, Taking Back Our Fiscal Future I will include in the record without objection.

[The article follows:]

July 2008

A BALANCED APPROACH TO RESTORING FISCAL RESPONSIBILITY

In a recent paper, "Taking Back Our Fiscal Future," a group of policy analysts from several Washington think tanks proposed a radical change in budget procedures related to Social Security, Medicare, and Medicaid as a way to address budget deficits projected for future decades.

We agree that the nation faces large, persistent budget deficits that would ultimately risk significant damage to the economy. We also concur that policymakers should begin now to make the tough choices needed to avert such deficits.

But we believe the proposal set forth in "Taking Back Our Fiscal Future" is misguided. We believe there are better ways to begin tackling projected deficits, which we describe in this paper.

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Nancy Altman
Kenneth Apfel
James Blum
J. Bradford DeLong
Peter Diamond
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Charles Schultze
Robert Solow
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Executive Summary

In a recent paper, "Taking Back Our Fiscal Future," a group of policy analysts from several Washington think tanks proposed a radical change in budget procedures related to Social Security, Medicare, and Medicaid as a way to address budget deficits projected for future decades. They urged Congress to establish 30-year budgets, or caps, for these programs. The White House would conduct a review every five years. If it projected that expenditures would exceed the caps, the programs would face automatic cuts or related tax increases.

We agree that the nation faces large, persistent budget deficits that would ultimately risk significant damage to the economy. We also concur that policymakers should begin now to make the tough choices needed to avert such deficits.

But we believe the proposal set forth in "Taking Back Our Fiscal Future" (hereafter referred to as TBOFF) is misguided. It could jeopardize the health and economic security of the poor, the elderly, and people with serious disabilities. For one thing, it does not focus adequate attention on the main driver of our fiscal problem — the relentless rise in health care costs throughout the U.S. health care system. Without measures to slow the growth of total (public and private) health care spending, no solution to the nation's fiscal challenges will prove sustainable. For another, it does not propose any action to restrain the hundreds of billions of dollars in entitlements that are delivered through the tax code and flow largely to more affluent Americans.

THE SIGNATORIES

This information is for identification purposes only. The material in this document represents the views solely of the individuals listed here, not of the institutions with which they are, or have been, affiliated.

Henry Aaron is a Senior Fellow, and the former Director of Economic Studies, at the Brookings Institution.

Nancy Altman is an expert, author, and lecturer on Social Security and private pensions. She served as chief aide to Alan Greenspan when he chaired the 1982-83 Social Security Commission and, before that, was advisor on Social Security to Senator John Danforth.

Kenneth Apfel is former Commissioner of Social Security and former Associate Director for Human Resources at the Office of Management and Budget. He is now a Professor of Public Policy at the University of Maryland.

James Blum is former Deputy Director of the Congressional Budget Office.

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Peter Diamond, widely regarded as one of the world's foremost experts on the economics of retirement, is Institute Professor and Professor of Economics at the Massachusetts Institute of Technology and a past President of the American Economic Association.

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Marilyn Moon is Vice President and Director of the Health Program at the American Institutes for Research. She is a former Public Trustee of the Social Security and Medicare Trust Funds and a former Senior Fellow at the Urban Institute.

Van Doorn Ooms is former Chief Economist of the Office of Management and Budget, the House Budget Committee, and the Senate Budget Committee, and is former Senior Vice President and Director of Research for the Committee for Economic Development.

Uwe Reinhardt is a Professor of Economics at Princeton University. An expert on health care, he also serves as President of the International Health Economics Association and was chair of the Commission on Rationalizing Health Care Resources for the state of New Jersey.

Charles Schultze is Senior Fellow Emeritus at the Brookings Institution, where he also served as Director of Economic Studies. He has served as Director of the Office of Management and Budget (then called the Bureau of the Budget) and Chair of the President's Council of Economic Advisers.

Robert Solow is Emeritus Institute Professor and Professor of Economics at the Massachusetts Institute of Technology. He was awarded the Nobel Prize in economics for his work on economic growth, and he received the John Bates Clark Award (given to the best economist under age 40) from the American Economic Association, where he is also a past President.

Paul Van de Water is Vice President for Health Policy at the National Academy of Social Insurance and a Senior Fellow at the Center on Budget and Policy Priorities. He is former Assistant Director for Budget Analysis at the Congressional Budget Office and former Assistant Deputy Commissioner for Policy at the Social Security Administration.

We believe there are better ways to begin tackling projected deficits, which we describe below.

In addition, TBOFF[1] would establish budget procedures that closely resemble failed approaches of the past. We believe that the proposal's formulaic budget caps backed by automatic cuts would fail to reduce projected deficits, just as when Congress tried such an approach under the 1985 Gramm-Rudman-Hollings law.

We believe the TBOFF proposal is ill-advised for three main reasons.

- **First, TBOFF is unbalanced.** It would subject Social Security, Medicare, and Medicaid to the threat of automatic cuts while giving a free pass to the open-ended entitlements (or "tax expenditures") enshrined in the tax code. These tax entitlements cost hundreds of billions of dollars a year, and their benefits flow largely to more affluent Americans. Nor would TBOFF place any obstacle in the way of deficit-financed tax cuts (or increases in other spending) even as Social Security, Medicare, and Medicaid faced potentially deep reductions based on projections of spending as much as three decades in the future. Yet over the next 75 years, the cost just of making permanent the 2001 and 2003 tax cuts is 3½ times the size of the entire Social Security shortfall. Thus, the plan departs from the "shared sacrifice" approach that has characterized the major, successful deficit-reduction laws of recent decades, such as those enacted in 1990 and 1993. Those agreements resulted when policymakers placed all parts of the budget "on the table" and developed balanced packages that combined reductions in major programs (particularly Medicare) with increases in taxes.

- **Second, TBOFF seeks to force action to substantially reduce projected expenditures for Medicare and Medicaid without requiring measures to restrain the growth of health care spending throughout the U.S. health care system.** The main driver of the high growth in projected expenditures for Medicare and Medicaid is the continued high growth in health care costs systemwide, not features unique to these two programs. For 30 years, per beneficiary spending in Medicare and Medicaid has grown at rates nearly identical to those for the health care system as a whole. As Congressional Budget Office director Peter Orszag recently noted, "Put simply, health care costs are the single most important factor influencing the federal government's budget trajectory."[2] Fundamental, systemwide reform of health care financing and delivery is the key to controlling Medicare and Medicaid expenditures — and reducing projected long-term deficits — without imposing draconian cuts that would harm the poor, the elderly, and people with serious disabilities.

- **Third, budget targets enforced by automatic cuts have proved ineffective in curbing past deficits, and there is no reason to think they will succeed in the future.** Under TBOFF, if the administration in office projected that expenditures for Medicare, Medicaid, or Social Security would exceed the caps that had been set for the next 30 years, automatic cuts would take effect. However, when policymakers previously tried to use budget targets backed by automatic cuts to force tough budget choices — under the 1985 and 1987 Gramm-Rudman-Hollings laws — the efforts failed. Policymakers first resorted to rosy assumptions to claim that the targets would be met and, when rosy scenarios proved insufficient, they resorted to accounting gimmicks and

[1] The paper is available on the websites of the Brookings Institution (http://www.brookings.edu/~/media/Files/rc/papers/2008/04_fiscal_future/04_fiscal_future.pdf) and the Heritage Foundation (http://www.heritage.org/Research/Budget/upload/takingbackourfiscalfuture.pdf).

[2] Peter Orszag, "Health Care and Behavioral Economics: A Presentation to the National Academy of Social Insurance," May 29, 2008.

timing shifts in order to avert the automatic cuts. When such evasions were not enough, they waived or raised the budget targets. Ultimately, policymakers repealed the whole framework because it failed to produce the intended results. Opportunities for evasion under TBOFF would, if anything, be even greater. Projections of health care expenditures as much as three decades in the future — and hence of Medicare and Medicaid costs — vary widely among experts and involve considerable guesswork about future trends in medical technology and other matters. The potential for future administrations and Congresses to use rosy assumptions to avoid unpopular actions would be great.

In short, the TBOFF proposal is fundamentally flawed. If it worked, it could undermine the defined-benefit structure of Social Security, Medicare, and Medicaid, without adequately addressing the systemwide rise in health care spending that underlies our fiscal problems. And it would focus deficit-cutting attention on programs that serve needier members of our society without a comparable focus on tax breaks for the more economically secure. If TBOFF did not work, it could prove counterproductive — by encouraging policymakers who were beginning to feel pressure to address long-term deficits to substitute TBOFF's procedural change for tough budgetary choices, only to have TBOFF's easily-evaded budget procedures subsequently fail to produce meaningful results. In the interim, the existence of the TBOFF procedures could create an illusion of progress, giving policymakers a false sense of security and easing pressure on them to strike effective bipartisan deals for long-term deficit reduction.

Finally, TBOFF is exceedingly vague in critical respects. Would the caps for each of the three large programs be set in dollar terms, as a share of the Gross Domestic Product, as a function of other economic variables, or in some entirely different manner? At what levels would the caps be set and how would they be adjusted over time? Would the automatic cuts take the form of benefit reductions, cuts in provider payments, increases in beneficiary premiums or copayments, tax increases, or some combination thereof?[3] TBOFF is silent on all of these questions. While urging policymakers to make tough choices, TBOFF's authors skirted the tough choices needed to convert their proposal into a concrete plan.

Rather than spending time trying to hammer out complex budget procedures of dubious merit and effectiveness, policymakers should focus on actual steps they can start taking to reduce projected deficits by slowing the growth of health care spending throughout the U.S. health care system while also reforming Medicare, closing the Social Security shortfall, and raising more revenue. While policymakers may not yet be ready to address such matters fully, they can begin by seeking "grand bargains" involving changes in both the big spending programs and taxes, including the changes suggested below. To be sure, some of these changes will be difficult to enact on their own. But, in the spirit of "shared sacrifice" as exemplified by the deficit-reduction packages of 1990 and 1993, these measures may be achievable as part of overall deficit-reduction packages. (Note: Not all signatories to this statement favor all of the following measures, but all favor at least a majority of them.)

- Adopting recommendations of Congress' Medicare Payment Advisory Commission, which could generate substantial savings;
- Increasing the Medicare premiums that affluent beneficiaries pay;

[3] As another illustration of TBOFF's vagueness, the TBOFF document even suggests at one point that a projection that expenditures for these programs would exceed the caps could trigger the formation of a commission to make recommendations to Congress for "closing the gap," although TBOFF's primary focus clearly is on automatic spending reductions or comparable automatic mechanisms.

- Instituting vigorous research programs to determine the comparative effectiveness of different health care treatments and procedures as well as what is causing the huge differences in health care costs across the country, and using the results as the basis for new policies to restrain health care costs without compromising health care quality;

- Curbing or eliminating outdated or unproductive tax expenditures;

- Switching to the Bureau of Labor Statistics' alternative, more accurate Consumer Price Index in computing the annual cost-of-living adjustments in Social Security and other entitlement programs (while taking steps to shield low-income and other vulnerable beneficiaries) and the annual inflation adjustments in the tax code;

- Reforming farm price supports; and

- Adhering to Pay-As-You-Go rules for both increases in mandatory programs and tax cuts.

While, taken together, these proposals would have a substantial effect on future deficits, policymakers will need ultimately to enact more extensive measures to achieve long-term fiscal sustainability. But, they need to get started. Working to reach agreement on measures such as those listed here would be much more productive than spending the next several years haggling over the contentious issues that would have to be resolved to turn TBOFF into a concrete plan and implement it, especially since the TBOFF procedures are not likely to lead to significant deficit reduction anyway.

In the following pages, we explain in greater detail why procedural fixes like those proposed in TBOFF would likely do more harm than good, and we elaborate on specific measures to consider that would be more fruitful in helping the nation start to take back its fiscal future.

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A BALANCED APPROACH
TO RESTORING FISCAL RESPONSIBILITY

I. An Unbalanced Approach

Giving short shrift to the need for more revenues

By focusing exclusively on expenditures for Social Security, Medicare, and Medicaid, TBOFF understates how much recent tax cuts have exacerbated the nation's long-term fiscal problem and glosses over how important added revenues can be in helping address the problem.

Over the next 75 years, the costs of making the 2001 and 2003 tax cuts permanent is 3½ times the size of the Social Security shortfall. The Social Security trustees project that the Social Security imbalance will equal 0.56 percent of the Gross Domestic Product over the next 75 years. Based on Joint Tax Committee and Social Security Administration estimates, the costs of extending the tax cuts is approximately 1.95 percent of GDP over the same period.[4] Indeed, *just the cost of extending the tax cuts for the top 1 percent of Americans — those with incomes over $450,000 — exceeds the entire Social Security shortfall.*[5]

TBOFF includes a section on "myths and realities" that appropriately rejects as myths the assertions that we can grow our way out of our budget problem or solve the problem by eliminating "waste." But it also lists as a "myth" the statement that "we just need to raise taxes starting with rolling back some or all of the Bush tax cuts." This is a "straw man." Of course, one cannot solve the entire long-term budget problem just by undoing — or paying for the extension of — the 2001 and 2003 tax cuts, and no serious analyst suggests that. Nor should policymakers raise revenues so much that tax increases alone would close the projected long-term fiscal gap. But policymakers will face important decisions very soon with regard to revenues. They will have to decide whether to let the 2001 and 2003 tax cuts expire and whether to pay for the tax cuts they elect to extend. If they do either, *that alone would eliminate more than half of the projected fiscal gap through 2050.*[6] This and other revenue issues deserve more serious consideration than TBOFF accords them.

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[4] The cost of the tax cuts includes the cost of the portion of Alternative Minimum Tax (AMT) relief needed to prevent the AMT from taking back much of the tax cuts' value. For further explanation, see Aviva Aron-Dine and Robert Greenstein, "The AMT's Growth Was Not Unintended," Center on Budget and Policy Priorities, November 30, 2007, and Kris Cox and Richard Kogan, "Long-Term Social Security Shortfall Smaller Than Cost of Extending Tax Cuts For Top 1 Percent," Center on Budget and Policy Priorities, March 31, 2008.

[5] The cost of the tax cuts for the top 1 percent will equal approximately 0.60 percent of GDP over the 75-year period, compared to 0.56 percent of GDP for the Social Security shortfall. In dollar terms, the tax cuts for the top 1 percent of households would cost $4.6 trillion over the next 75 years, while the Social Security trustees project the Social Security shortfall at $4.3 trillion. (The $4.3 trillion figure represents the "unfunded obligations" of the trust fund. All these figures are measured in present value. Estimates of the present-value cost of the tax cuts are based on the trustees' economic assumptions.)

[6] The long-term cost of extending the 2001 and 2003 tax cuts is slightly less than 2 percent of GDP. The Center on Budget and Policy Priorities has estimated that the fiscal gap through 2050 equals 3.2 percent of GDP. The size of the fiscal gap is larger over periods that extend further into the future. Although the amount of revenue associated with the 2001 and 2003 tax cuts is much smaller than the anticipated growth over time in expenditures for federal health care programs, the fact that the decision on the fate of the tax cuts affects revenue levels by a full 2 percent of GDP starting in the next few years, rather than by an amount that is initially small and grows gradually, means that the added revenue would produce interest savings that would compound from an early date. See Richard Kogan, Matt Fiedler, Aviva Aron-Dine, and James Horney, "The Long-Term Fiscal Outlook Is Bleak: Restoring Fiscal Sustainability Will Require Major Changes to Programs, Revenues, and the Nation's Health Care System," Center on Budget and Policy Priorities, January 29, 2007, at http://www.cbpp.org/1-29-07bud.pdf.

Ignoring federal retirement and health subsidies that go disproportionately to the affluent

Social Security, Medicare, and Medicaid are not the only large, open-ended federal commitments for retirement and health care. Federal tax expenditures for retirement and health care (including tax breaks for 401(k)s, IRAs, Keogh plans, Health Savings Accounts, and employer contributions for health insurance) cost about $300 billion a year and are growing rapidly. (Tax expenditures as a whole cost about $900 billion a year.) Former Federal Reserve Board Chairman Alan Greenspan has termed these and other tax expenditures "tax entitlements."

Nevertheless, TBOFF proposes no limits on the growth of these tax expenditures, in contrast to the limits it would impose on Social Security, Medicare, and Medicaid.[7] It focuses on entitlements on the spending side of the budget without placing a comparable focus on entitlements on the tax side of the budget.

This imbalance is especially troubling because the tax entitlements go disproportionately to people at higher income levels. In a Tax Policy Center analysis, Leonard Burman, William Gale, Matthew Hall, and Peter Orszag found that two-thirds of federal tax expenditures for retirement saving go to households in the top fifth of the income distribution.[8] In contrast, Social Security and Medicare benefits are spread far more evenly. Medicaid is, of course, targeted on people with low incomes. Thus, TBOFF would limit federal expenditures for the retirement and health care programs that provide an economic foundation for low- and middle-income families, while leaving untouched the open-ended and costly federal retirement and health care subsidies delivered through the tax code, which provide their largest benefits to upper-middle- and upper-income people and serve no social insurance function.

Such an approach would not only be inequitable but also would weaken the effort to curb deficits. Capping Social Security, Medicare, and Medicaid *without* constraining tax expenditures for health care and retirement would create perverse incentives for policymakers. When TBOFF's automatic-reduction mechanism kicked in, policymakers would be pushed to cut Social Security and Medicare but could "compensate" by expanding retirement and health care tax breaks. That would lessen or eliminate the deficit reduction. Moreover, such an approach would reduce federal retirement and health care programs that pool risk and maintain a progressive benefit structure (and thereby protect people who become poor, sick, or disabled), while expanding tax-based mechanisms that, by their nature, cannot effectively pool risk or perform a social insurance function.[9]

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[7] The joint statement says that "ultimately" the signatories would like to extend the type of budget procedures proposed for Social Security, Medicare, and Medicaid to tax expenditures and to all other entitlement programs (including those targeted on poor families), and it acknowledges (on the last page) that "the tax code is also on autopilot." But the TBOFF proposal itself does *not* subject the tax code — or any tax expenditures — to new budget procedures or restraints (because the signatories could not agree on that). As a result, under the proposal, the entitlement status of Social Security, Medicare, and Medicaid would end while tax expenditures for retirement and health care retain their open-ended character.

[8] Leonard E. Burman, William G. Gale, Matthew Hall, and Peter R. Orszag, "Distributional Effects of Defined Contribution Plans and Individual Retirement Accounts," Tax Policy Center, revised August 2004.

[9] TBOFF's discussion of Social Security raises other concerns as well. TBOFF portrays Social Security as a program on auto-pilot that lacks mechanisms to prevent its costs from growing to unsustainable levels and greatly straining the federal budget. In fact, Social Security already has its own built-in automatic adjustment mechanism — once its trust fund is exhausted, Social Security must reduce benefit levels to stay within the income it receives each year. The Social Security trustees project that if no action is taken, benefits will be reduced 22 percent in 2041. Of course, relying on such an approach would be undesirable for a number of reasons.

Wall Street Journal economics editor David Wessel focused on this shortcoming in a recent commentary on TBOFF's inadequacies. "Force Congress to limit spending, and history demonstrates that it will create new, unimagined tax credits to avoid those constraints," Wessel wrote. "Moreover, to a substantial degree the bottom of the population gets its goodies through spending; the top gets them through tax breaks (for retirement savings, mortgage interest, capital gains and the like) that are most valuable to those in upper-income brackets. Tackling benefits without tackling the tax code isn't wise."[10]

II. A Flawed Way to Address Projected Increasesin Medicare and Medicaid Costs

Downplaying rising health care costs

TBOFF glosses over the critical role that systemwide increases in health care spending play in fueling our long-term budget problem. As a result, its recommended response to increases in Medicare and Medicaid spending would not solve the fundamental problem. Furthermore, it would threaten the central achievement of those programs — providing the elderly, the disabled, and the poor with access to the same kind of health care that other Americans receive.

TBOFF portrays projected increases in Medicare and Medicaid costs as the key driver of the nation's fiscal problems. But it fails to note that for more than 30 years, the rate of growth in Medicare and Medicaid spending per beneficiary has closely tracked that of health care spending throughout the U.S. health care system.[11] That the rates of growth in costs are nearly identical is not surprising. Both private- and public-sector financed health care is delivered largely by the same health care providers in the same settings and relies on the same procedures and medications. This basic truth has prompted leading experts from across the political spectrum, including Congressional Budget Office director Peter Orszag, then-Comptroller General David Walker, and Gail Wilensky, administrator of what is now the Centers for Medicare & Medicaid Services under the first President Bush, to warn that policymakers will not be able to slow Medicare and Medicaid cost growth substantially without larger health care cost reform that slows health care costs systemwide. (See the box on page 8.) Yet TBOFF portrays health care cost reform as a secondary matter. It dismisses — as a budget "myth" to dispel — the statement that we merely need to deliver health care more efficiently.

Rising health care spending accounts for virtually all of the projected long-term federal budget deficit.[12] That is, were health care expenditures per person growing no faster than the economy as a

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Also, in calling for some type of new "expenditure budget" to measure whether Social Security is remaining on course financially, TBOFF seems to overlook the eminently reasonable measure that Social Security already employs for that purpose — the projection that the Social Security actuaries and trustees make each year of whether the program will be in close actuarial balance in the decades ahead.

[10] David Wessel, "Deficit Hawks Try, Try Again," *Wall Street Journal*, April 3, 2008, p. A2.

[11] From 1970 to 2006, Medicare spending per beneficiary rose at an average rate of 8.7 percent per year, compared to 9.7 percent for private health insurance. Centers for Medicare and Medicaid Services, "NHE [National Health Expenditure] Web Tables," January 2008, table 13 available at http://www.cms.hhs.gov/National HealthExpendData/downloads/tables.pdf. The cited figures refer to benefits commonly covered by Medicare and private health insurance.

[12] Henry J. Aaron, "Budget Crisis, Entitlement Crisis, Health Care Financing Problem — Which Is It?," Health Affairs, November/December 2007; 26(6): 1622-1633.

Experts Agree: Projected Medicare/Medicaid Costs Cannot Be Sharply Reduced Without Cost Reductions in the Overall Health Care System

"Many analysts believe that significantly constraining the growth of costs for Medicare and Medicaid over long periods of time, while maintaining broad access to health providers under those programs, can occur only in conjunction with slowing cost growth in the health care sector as a whole.

Ultimately, therefore, restraining costs in Medicare and Medicaid requires restraining overall health care costs."

— Peter Orszag, Director, Congressional Budget Office,
"Health Care and the Budget: Issues and Challenges for Reform,"
Testimony before the Committee on the Budget, U.S. Senate, June 21, 2007, p. 9.

"[F]ederal health spending trends should not be viewed in isolation from the health care system as a whole. For example, Medicare and Medicaid cannot grow over the long term at a slower rate than cost in the rest of the health care system without resulting in a two-tier health care system."

— David Walker, then Comptroller General of the United States,
"Long-Term Fiscal Issues: The Need for Social Security Reform,"
Testimony before the Committee on the Budget, U.S. House of Representatives, February 9, 2005, page 18.

"Thus sustaining a lower rate of spending growth per capita in Medicare will only happen if there is a comparable rate of spending growth in the private sector."

— Gail Wilensky, Senior Fellow, Project Hope,
"The Challenge of Medicare," in *Restoring Fiscal Sanity 2007: The Health Spending Challenge*,
Alice Rivlin et. al. (ed.), Brookings Institution Press, 2007, p. 88.

whole, the nation would face little if any long-term budget problem. Having said that, the changes needed to limit health care expenditures to the rate of economic growth would be very difficult to achieve without depriving millions of Americans of access to new advances in technology and health care that cure disease and prolong life. Therefore, reforms in other programs as well as more revenues must be part of any effort to address the nation's daunting long-term fiscal problem. But systemwide health care cost reform must be the central component of any such effort. Downplaying its significance is unwise.

Furthermore, the TBOFF statement implies that policymakers should limit the annual growth rate of per-beneficiary Medicare and Medicaid expenditures to a rate significantly below that of health care expenditures nationwide.[13] Doing so would represent a radical change in U.S. health care that would

[13] The TBOFF statement declares the claim that the nation's budget problems can be solved by reducing projected health care costs is a myth, and that undoing the current entitlement nature of Medicare and Medicaid is necessary because "even if these efforts [to reduce health care costs systemwide] are successful, medical care spending is almost certain to grow faster than the economy, and federal health care spending will still grow faster than federal revenues" (p. 4). The statement also declares that "improving the efficiency of the health care delivery system — not just for Medicare and Medicaid patients, but for everyone — has the potential to slow the growth of health care spending. Nevertheless, spending will continue to rise faster than GDP as long as new procedures and drugs appear in profusion and the demand for the better health and longer lives that these innovations are believed to produce remains high" (p. 6). The implication of these statements is that Medicare and Medicaid costs should be held to the rate of growth of GDP or revenues even as private-sector health care costs continue to rise at a faster rate.

either prove impossible to sustain over time or exacerbate the gaps between the health care available to aged, blind, and disabled people who are not affluent — and to poor people generally — and the health care available to other Americans.

If Medicare and Medicaid beneficiaries continue to have access to the same treatments and medical advances as other Americans, holding Medicare and Medicaid costs to a lower rate of growth year after year than the growth in private-sector health care costs would either (1) require massive increases in premiums and cost-sharing charges to Medicare and Medicaid beneficiaries, many of whom could ill afford them, or (2) generate substantial cost-shifting from the public programs to private-sector health care, with little or no reduction in the overall burden that rising health care costs place on the U.S. economy.

Alternatively, policymakers could hold growth in Medicare and Medicaid spending per person below the growth of private-sector health care spending *without* substantial cost-shifting by denying some advances in medical treatment and technology to children, parents, the elderly, and people with disabilities who depend on these programs to cover most or all of their health care. Such an approach would exacerbate existing economic and racial disparities in health status and longevity.[14]

In his *Wall Street Journal* commentary, Wessel observed that "A rule to restrain Medicare and Medicaid alone won't do it" and added that "by setting up a system that looks only at the federal spending on Medicare and Medicaid, they [TBOFF's authors] may be making it less likely that Congress deals with the overall societal problem of health care costs going up very rapidly."[15]

Finally, the White House determination every five years on whether Medicare and Medicaid were meeting their spending targets — and thus whether automatic cuts would occur — would turn on 30-year projections that necessarily would be highly uncertain and subject to substantial error.[16] In 1994, for example, the Medicare actuaries projected that total Medicare costs would reach $499 billion in 2005; the actual 2005 figure was $338 billion. Under TBOFF, the large degree of uncertainty inherent in long-term projections for Medicare and Medicaid would give an administration considerable latitude to use projections to serve its policy and political agenda. Even an administration with no agenda could mistakenly trigger massive Medicare cuts — or *fail* to trigger any congressional action — based on estimates that later proved far off the mark.

Placing health care for low-income Americans at risk

TBOFF calls for restricting projected Medicaid expenditures as well. Costs in Medicaid are escalating mainly because health care expenditures are growing systemwide, and to a lesser degree because the population is aging and employer health care coverage is eroding. But policymakers have little room to cut Medicaid without causing significant hardship.

[14] For a summary of disturbing new research that finds "large and growing" disparities in life expectancy between richer and poorer Americans that appear related in part to differences in the health care these individuals receive, see Robert Pear, "Gap in Life Expectancy Widens for the Nation," *New York Times*, March 23, 2008.

[15] David Wessel, "Deficit Hawks Try, Try Again"; brief analysis by David Wessel, Video: "Budget Wonks Tackle Federal Deficit," *Wall Street Journal*, April 3, 2008, http://link.brightcove.com/services/link/bcpid452319854/bctid1473784569.

[16] Under the Constitution, only the Executive Branch can make a determination that a budget trigger generating automatic changes has been pulled. A law requiring the use of Congressional Budget Office estimates to make such a determination would be unconstitutional.

Medicaid already pays doctors, hospitals, and other health care providers much less than Medicare and private-sector health care do, and many physicians already refuse Medicaid patients because fees are too low. Cutting fees further could prompt more physicians and some hospitals to refuse to serve Medicaid patients. Moreover, Medicaid beneficiaries are poor and cannot pay much more in co-payments, deductibles, and premiums. Where would the reductions come from? TBOFF devotes one sentence to this dilemma, simply saying that Medicaid reforms "would have to focus primarily on [the long-term care] portion of the program." In the 2005 Deficit Reduction Act, the President and Congress enacted cuts in Medicaid's long-term care component. Are additional large savings achievable in the absence of systemwide health care reform? If so, what might they be? The TBOFF statement is silent on these matters.[17]

Furthermore, Medicaid expenditures will necessarily *increase* if employer coverage continues to erode and Medicaid is the only coverage available to a growing number of low-wage workers and their families. Expenditures will rise further if states reach and enroll the several million low-income children who are eligible for Medicaid but are now uninsured, something both Democrats and Republicans say they favor. Under TBOFF, the higher outlays from these developments could trigger automatic cuts in Medicaid. (The proposal calls for limiting Medicaid growth to "sustainable" levels, and parts of the TBOFF document imply that a sustainable growth rate is one that does not exceed the growth rate of the economy. Under such a scenario, Medicaid would face the threat of severe cuts. If Medicaid needed to help fill coverage gaps created by further erosion of employer-based coverage, or if it reached currently uninsured poor children, the cuts would have to be still deeper.)

III. A Focus on Budget Procedures That Will Likely Prove Ineffective

Giving Policymakers a Justification for Postponing Action

Although TBOFF is intended to induce policymakers to act, it could delay action.

Past deficit-reduction efforts have succeeded when policymakers put all parts of the budget — including taxes — on the table. The landmark 1990 bipartisan deficit reduction agreement is a striking example. It generated a sense of shared sacrifice. Lawmakers who defended particular programs were willing to let Congress reduce them because their colleagues also were cutting other programs. Lawmakers who generally opposed tax increases were willing to accept some because other lawmakers had agreed to cut spending as well. Policymakers should return to this type of approach, putting all parts of the budget on the table and taking major deficit-reduction steps in both spending programs and revenues.

TBOFF would likely make it harder to achieve that sort of cooperation. If anti-tax conservatives believe they can end the entitlement character of Social Security, Medicare, and Medicaid and likely secure reductions in those programs' benefits *without* having to entertain the need for tax increases or even allow any portion of the 2001 and 2003 tax cuts to expire, why would they negotiate a balanced deficit-reduction package that encompasses both spending and revenues? By essentially defining the long-term problem as purely an expenditure problem, the TBOFF paper is already encouraging some

[17] A substantial share of the costs of Medicaid's long-term care component is for housing and custodial and other non-health care services. As a result, increases in health care costs generally will likely play a somewhat smaller role, and demographic changes a somewhat larger role, in driving future cost increases in Medicaid long-term care than in Medicare and the rest of Medicaid.

leading conservatives to adhere to a one-sided approach[18] and to resist negotiating a "grand bargain" in which all parts of the budget, including taxes, are on the table.

TBOFF also could give policymakers a convenient rationale for postponing hard choices for five years, and possibly for subsequent five-year periods through the imaginative use of budget projection gimmicks. After the 2008 election, policymakers could face pressure to begin addressing the nation's long-term fiscal problems. Instead of recommending specific measures to cut specific government expenditures, raise specific taxes, and slow the systemic increase of health care spending, however, policymakers could advance something like the TBOFF proposal and thereby put off actual hard policy choices for at least five years.

Moreover, TBOFF provides no assurance that policymakers would make hard choices even after five years. In the past, budget procedures that have sought to compel policymakers to make substantive choices by threatening painful automatic cuts if they fail to act have not achieved major deficit reduction. The 1985 and 1987 Gramm-Rudman-Hollings laws set annual deficit targets and mandated annual automatic spending cuts if the targets were expected to be missed. When substantial automatic cuts loomed, the White House produced extremely rosy budget estimates to make the shortfall "disappear" on paper or to reduce the size of the required cuts. Then the Administration and Congress either enacted gimmicks — such as asset sales, timing shifts in program spending, and moving entities "off budget" — to address much of the remaining shortfall or they raised the deficit target. Congress repealed the Gramm-Rudman-Hollings law in 1990 because it had failed.[19] As Congressional Budget Office Director June E. O'Neill testified in 1995:

> "Instead of enacting the changes in laws governing revenues and spending necessary to reduce the deficit, the President and the Congress were able to avoid the intent of the act by changing the deficit targets or by basing budget estimates on overly optimistic forecasts. For example, the original deficit target for 1990, the last year the Gramm-Rudman-Hollings procedures were fully in place, was $36 billion. The revised 1990 target, established in 1987, was $100 billion. The reported deficit for that year was $220 billion. The deficit for 1993 (the year in which the revised targets were to require a balanced budget) was $255 billion."[20]

As numerous budget experts have counseled for many years about large budget deficits, "the process isn't the problem; the problem is the problem." TBOFF is the latest in a long series of proposals that seek to change the budget *process* in the hope that this will induce the President and Congress to

[18] For example, Rep. Paul Ryan, the ranking Republican member of the House Budget Committee, recently introduced legislation (H.R. 6110) that includes a tax cut that the Urban Institute-Brookings Institution Tax Policy Center estimates would cost $5 trillion to $6 trillion over ten years even when dynamic scoring assumptions are used and, thus, would constitute "by far the largest tax cut in **[U.S.]** history." To address long-term deficits, as greatly magnified by this tax cut, Ryan's bill also would cut Medicaid 73 percent, and Medicare 68 percent, below the budget baseline by 2082. In explaining the rationale for the legislation, Rep. Ryan cited TBOFF extensively. He also included the TBOFF proposal itself in the legislation.

[19] During the Gramm-Rudman-Hollings era, the invariable use of overly optimistic budget estimates to substitute for action had a second undesirable effect: it exacerbated public cynicism about official budget numbers. Many in the media and the public began to believe that virtually all budget figures were fictions and all budget plans were illusions, to the detriment of substantive debate. For a more detailed discussion of the failings of and lessons to be drawn from Gramm-Rudman-Hollings, see Congressional Budget Office, "The Budget Process and Deficit Reduction," Chapter 6, *The Economic and Budget Outlook: Fiscal Years 1994-1998*, January 1993.

[20] Congressional Budget Office director June E. O'Neill, testimony before the Subcommittee on Legislative and Budget Process and the Subcommittee on Rules and Organization of the House of the House Committee on Rules, July 13, 1995, p. 4.

make tough decisions on policies and programs. But as the Congressional Budget Office concluded after Congress repealed Gramm-Rudman-Hollings: "The experience under Gramm-Rudman-Hollings demonstrated that if the President and the Congress are unwilling to agree on a painful deficit reduction package, it is unlikely that any budget procedure can force them to agree. Instead, budgetary legerdemain is likely to be used to meet the letter of the law, and the hard decisions that would achieve real, permanent deficit reduction will be avoided."[21]

IV. What To Do Now

Take immediate policy steps to start addressing the long-term fiscal crisis

The President and Congress may not yet be ready to address such matters as systemwide health care cost reform — although they should start educating the public about the need to do so — but they can start taking important steps now to reduce projected deficits. Rather than spending time trying to hammer out budget procedures of dubious merit and effectiveness, policymakers should focus on real policy choices and begin the process of seeking bipartisan support for legislative packages that make specific changes both to curb spending and to raise revenue. Policymakers could consider a number of measures, including the following: (Note: Not all signatories to this statement favor all of the following measures, but all favor at least a majority of these options.)

1. **Adopt the MedPAC recommendations**. Congress has established the Medicare Payment Advisory Commission (or MedPAC) — an expert, bipartisan commission to advise it on Medicare. MedPAC conducts high quality research and provides extensive policy recommendations to Congress each year. Unfortunately, policymakers have not acted on some key MedPAC recommendations.

MedPAC's most significant recommendation is to halt the large overpayments to private insurance companies in the Medicare Advantage (MA) program.[22] Medicare now pays private insurance companies more than it costs to treat the same patients in traditional Medicare. MedPAC has unanimously recommended that policymakers end these excess payments. This one change would save up to $150 billion over ten years. Other MedPAC recommendations would save smaller but significant sums. (For example, eliminating duplicate medical education payments to teaching hospitals for Medicare Advantage enrollees would save $16 billion over ten years.) Although, as noted above, larger Medicare savings will require systemwide health care reform, that is no justification for failing to act on the MedPAC recommendations now.

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[21] Congressional Budget Office, "The Budget Process and Deficit Reduction," Chapter 6, *The Economic and Budget Outlook: Fiscal_Years 1994-1998*, January 1993, p. 87. In fact, then-Congressional Budget Office director Robert Reischauer, writing about budget gimmickry, reported in 1990 that "In the pre-GRH era, these gimmicks occurred so infrequently that CBO did not keep systematic track of them. In the GRH era, fully half of the apparent deficit reduction has been achieved by such devices." See Robert Reischauer, "Taxes and Spending Under Gramm-Rudman-Hollings, *National Tax Journal*, vol. 43, #3, September, 1990, p. 232. The 1994 CBO report found that, in contrast to GRH, the pay-as-you-go rules and discretionary spending caps enacted to enforce the 1990 deficit reduction package were effective because "budget procedures are much better at enforcing deficit reduction agreements than at forcing such agreements to be reached....if the President and the Congress agree on and enact a painful package of spending cuts and tax increases to reduce the deficit, budget procedures that highlight and penalize deviations from that agreement can be effective." (pp. 86 - 87)

[22] Medicare Payment Advisory Commission, *Report to the Congress: Issues in a Modernized Medicare Program*, June 2005, chapter 3.

2. **Consider increases in Medicare premiums for affluent beneficiaries**. Currently, affluent beneficiaries pay higher premiums than do other enrollees for Medicare Part B, which covers physician and outpatient services. In contrast, all beneficiaries pay the same premiums for Medicare Part D, which covers the new prescription drug benefit.[23] Given Medicare's financial problems, targeted premium increases for those who can afford them make sense, as long as they are designed not to drive affluent beneficiaries from the program (and are not extended over time to beneficiaries of modest means who cannot afford them).[24] Congress can secure some modest savings here without undermining Medicare's universal social-insurance nature. (Note: The increased premiums could be collected most efficiently through the tax system.)

3. **Establish an adequately funded research institution to evaluate such matters as the comparative effectiveness of different health care treatments and procedures and the sharp divergence in health care expenditures in various parts of the country — and thereby build knowledge about how to slow health care spending growth without compromising health care quality by curbing care that is not worth what it costs.** Without such information, decisionmakers in both the public and private sectors are limited in their ability to design effective expenditure-reducing measures. Congressional Budget Office director Peter Orszag and other experts have highlighted the importance of such work in addressing our nation's daunting fiscal problems.[25] While the impact of such research on future health care spending is extremely difficult to estimate, the Congressional Budget Office has concluded that "Generating additional information about comparative effectiveness and making corresponding changes in incentives would seem likely to reduce health care spending over time--potentially to a significant degree."[26] (Note: The Children's Health and Medicare Protection Act of 2007, which the House of Representatives passed in August 2007, would have established a Center for Comparative Effectiveness Research within the Agency for Healthcare Research and Quality).

4. **Close tax loopholes and eliminate or limit unwarranted or outdated tax expenditures.** The Joint Tax Committee and the Congressional Budget Office have each issued reports outlining options for limiting or eliminating tax expenditures and closing tax loopholes.[27] While many of these options are highly controversial, some that may be less controversial could still produce significant savings. For example, simply taking steps to prevent corporations from simultaneously claiming U.S. tax deductions for their foreign business expenses *and* avoiding U.S. tax on their foreign earnings could save about $100 billion over ten years.

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[23] Subsidies are provided to cover the cost of premiums for beneficiaries with very low incomes.

[24] The President's fiscal 2009 budget proposed to extend income-related premiums (as the higher premiums on affluent Medicare beneficiaries are known) to Medicare Part D, as well. The budget also proposed, however, to eliminate the annual indexing of income levels above which the higher premiums apply (both for Part B and Part D), so that the higher premiums would increasingly apply over time to beneficiaries with relatively modest incomes. The Congressional Budget Office estimated the President's proposals would save about $30 billion over the next ten years.

[25] Peter R. Orszag and Philip Ellis, "Addressing Rising Health Care Costs—A View from the Congressional Budget Office," *New England Journal of Medicine*, November 6, 2007, pp. 1885-7; Institute of Medicine, *Knowing What Works in Health Care: A Roadmap for the Nation.* Washington: National Academies Press, 2008; Medicare Payment Advisory Commission, *Promoting Greater Efficiency in* Medicare, Washington, Washington, June 2007, chapter 2; Peter J. Neumann, *Getting Better Value for Our Health Care* Spending, Washington: NIHCM Foundation, July 2007; John E. Wennberg *et al., Tracking the Care of Patients with Severe Chronic Illness: The Dartmouth Atlas of Health Care 2008*, Lebanon, NH: Dartmouth Institute for Health Policy and Clinical Practice, 2008, pp. 94-97.

[26] Congressional Budget Office, Research on the Comparative Effectiveness of Medical Treatments, December 2007.

[27] Joint Committee on Taxation, "Options to Improve Tax Compliance and Reform Tax Expenditures, " JCS-02-05, January 27, 2005, and Congressional Budget Office, "Budget Options," February 2007.

5. In computing annual cost-of-living adjustments in Social Security and other entitlement programs and the annual indexing of income-tax brackets and other features of the tax code, adopt the changes that the Bureau of Labor Statistics has developed to improve the accuracy of the consumer price index. Experts generally agree that the alternative CPI (sometimes called the "superlative CPI" or "chained CPI") measures inflation more accurately than does the official version now in use. The Social Security actuaries estimate that this step alone would close more than one-quarter of the projected Social Security shortfall over the next 75 years. Analysis from several years ago indicated that this policy change would reduce deficits by more than $200 billion over the succeeding decade from reduced spending on Social Security and other indexed entitlements and from increased revenues, and the savings would grow larger in subsequent decades. Policymakers should use a portion of the resulting Social Security savings to shield vulnerable beneficiaries from hardship that could occur as a result of this change.

6. Reform farm subsidy programs. Most independent policy analysts agree that a significant portion of the approximately $15 billion a year spent on farm income stabilization does not produce significant public benefits. Many analysts also believe that U.S. farm policies reduce the earnings of very poor farmers in developing nations because U.S. subsidies drive down world prices by artificially inflating U.S. farm production. Proponents of the farm subsidies argue the subsidies are needed to sustain small family farms. But a substantial portion of the benefits goes to very large, profitable farm operations. Reforms in the farm programs, such as eliminating subsidies to high-income farm owners, would produce budget savings and reduce market distortions, while still allowing the programs to meet the stabilization needs of the agricultural sector.

7. Adhere to Pay-As-You-Go rules for mandatory spending and tax cuts. Offsetting the cost of extending temporary tax cuts and entitlement increases that are slated to expire, as well as of new tax cuts and entitlement expansions, would make a significant contribution to addressing the long-term fiscal problem.[28]

[28] Support for Pay-As-You-Go rules does not suggest that net savings achieved in deficit-reduction legislation should be available to offset tax cuts or entitlement increases provided in other legislation. Deficit reduction legislation should specify that the net savings the legislation achieves are not available to offset the costs of other legislation. The 1990 deficit-reduction legislation that created the original statutory Pay-As-You-Go rule included that prohibition. So did the deficit reduction bills that policymakers enacted in 1993 and 1997. Similarly, the current Senate Pay-As-You-Go rule specifies that net deficit savings achieved in a budget reconciliation bill are not available to offset the costs of other legislation.

Chairman RYAN. Joe Antos, Bob Bixby, Stuart Butler, Paul Cullinan, Allison Fraser, Bill Galston, Ron Haskins, Julia Isaacs, Maya MacGuineas, Will Marshall, Pietro Nivola, Rudy Penner, Bob Reischauer, Alice Rivlin, Bell Sawhill, Gene Steuerle, a pretty good list, people from both sides of the aisle with specific recommendations on how to improve the budget process, which are encapsulated in these bills we are talking about here.

I want to look at a certain section which I think had you a lot to do with, specifically, there are three recommendations I want your take on. First you recommend, and I will read it from the document here, "Congress and President should enact explicit long-term budgets for Social Security, Medicare and Medicaid that are sustainable, set limits on automatic spending growth and have required review every 5 years.” Can you tell us about the rationale for this recommendation and whether this rationale was shared by the bipartisan group of experts that signed this document?

Second, is this issue, “the rules for the 5-year window trigger for action forcing device that requires explicit decisions when projected spending exceeds budgeted amounts.” That is basically what Mr. Mulvaney’s bill does. Can you discuss how these triggers might work in your judgment?

Ms. FRASER. Yes, thank you very much.

Chairman RYAN. And then third, third, you can go back if you want to, but I just want to in the interest of time pack my question pretty quickly here. You recommend, “The long-run cost of these three programs should be visible in the budget at all times and considered when decisions are made. The benefits should not be increased either at the 5-year review or in between without insuring that they are fully financed, that is the other idea that is in Mr. Mulvaney’s bill. Can you talk a bit about a rationale for this recommendation and whether this idea was supported by the bipartisan group of experts?

Ms. FRASER. Yes, thank you very much. We published this in 2008 after nearly a year of working together, going over what our big concerns are over fiscal policy. And let me just read the two bullets where we came to agreement: “We have unsustainable deficits in the Federal budget which threaten the health and vigor of the American economy. The first step towards establishing budget responsibility is to reform the budget decision process so that the major drivers of the escalating deficits, Social Security, Medicare and Medicaid, are no longer on budgetary autopilot.” We thought this was very important, both from the short-term perspective and the traditional 10-year budget window, but also, and more importantly, over the longer term.

So that is where we came up with the three basic recommendations that we went through. And we spent a lot of time doing this, because as you can tell by the individuals associated with this, there are a lot of diverse, very diverse ideological opinions and core beliefs. But it was a bipartisan view that we have to change course and that the biggest threat really is the fact that entitlement spending, especially on the Big Three is on budgetary autopilot.

So with that, we thought it was fundamentally important that we change the dynamics, that Congress change the dynamics that trade-offs are made in the budgetary process by bringing these three entitlement programs on. We do believe that all three of them are very important in our society and our culture, but we believe that they have to be transformed and modernized so that they are both sustainable and affordable.

Since they are, in essence, especially Social Security and Medicare, longer term, people rely on—millions of people rely on them exclusively in retirement, that there should not be a number of sort of whipsawing changes that occur in the same way that could occur in discretionary spending. Hence, we thought a regular review of say every 5 years that was the suggestion would allow for more sustainable or planning kinds of policies that people could rely on, policy changes.

So we didn't want to see changes that would happen every year as in discretionary spending. That is why we recommended sort of 5-year, 7-year kind of period.

Again, this is was a bipartisan view. I would say that one of the differences is though we all believed that spending is the problem, we also believe that we should have a full and very formal overhaul of our Tax Code. And we should have a debate about how big we want government to be, and we should have a debate about how high revenue should be, and there are provisions in there to do that. And I would be happy to talk about my views on how big government should be, and we could have a robust discussion about that, but that was outside of your three questions.

So what we thought is by setting a course that everybody could agree with about how big government should be, that should involve both the Congress and to the President that we should set sort of the track that we should be on, and then have some sort of way to keep us on track, hence the regular review. If Congress and the President did not come together to ensure that fiscal policy, especially over these biggest drivers was in adherence with those benchmarks, then there would be some sort of forcing action through a trigger to make sure that that happened.

Now one of the things that we actually recommended as opposed the across-the-board sequestration was having actual policy triggers and there are a number of ways to do that. For example, you could increase premiums in Medicare, we could increase income adjusting in Social Security, lots of policy ways to include in the triggers themselves.

And then lastly, again, I forget your third question.

Chairman RYAN. Third question, let me get it, it is in the document here, "the long-run cost of the programs should be visible at all times without insuring they are fully financed." Basically, how do you think the trigger ought to be worked, that is basically what you just got into?

Ms. FRASER. But if I could add——

Chairman RYAN. So it was the policy trigger, I think that the sequester was what Mr. Van Hollen said, what do you think is the best trigger? I think you more or less answered that. You are saying the backup ought to be a policy, a predesigned policy trigger is what you are basically saying is what the trigger ought to be versus, say, a sequester? That was the question.

Ms. FRASER. That was my recommendation to consider a policy. Because a sequester—you all are dealing with what the sequester is or is not going to be at the end of the year. And our thoughts were, well, let's have something that we can all agree on in advance that could be ratcheted up.

Chairman RYAN. Is the thinking that that is a trigger that is more likely to stick or that that is a trigger that is more focused on these programs, and therefore, it will more likely require actual policy prescriptions from Congress before that occurs. So, for instance, we passed our reconciliation package to prevent the sequester in the first year, nothing is happening in the Senate, we have the lame duck issue we are going to be dealing with. People can speculate as to whether the sequester will or will not occur if it will be replaced or not. Is the thinking that a policy trigger is better because it is more specific, less across the board, and more directed towards the very programs of the drivers of our debt, is that the basic rationale?

Ms. FRASER. Yes. And if I could just elaborate on a point of making sure that there is more transparency in what our long term path is. We thought that was especially important, so there is a debt limit that is set, but there is never any sort of measure or metric as to how high we want the future, our excess obligations stemming from some of these programs to be and we thought that was especially important.

Chairman RYAN. That is what where we thought was most intriguing about this. What Mr. Mulvaney, and I will let him speak for himself and his bill, a bill that all of us here on the committee on this side are behind, is it is all about confident and trajectory. Are we getting our trajectory of debt under control, and are we confident that we are going to meet that trajectory. And therefore, to the point that some say, well, arbitrary caps on spending in and of themselves don't really give you confidence that you are going to meet this trajectory of the debt because that means a future Congress at some other time will actually do the right thing, then to meet this benchmark. But if we actually are forcing ourselves to deal with the drivers of the debt, changing the laws themselves that are the cause for this run up in debt, and then putting enforcement mechanisms to make sure that those change in laws actually do continue and persist, then we have confidence that this trajectory of debt is under control.

And by measuring the outcomes in the outyears of this debt, we can better send signals to the credit markets, we can better keep the integrity of our currency, we can better give seniors, or soon-to-be seniors or would-be seniors in their 40s and 50s more confidence that the Federal Government will be able to make its commitment that it is making to people which today has no means of making.

So what we believe this does is this gives us the confidence that we will get the debt under control, and it gives us the tools to make sure that the changes we need to make are made and continue so that government can keep its promises to people, and we can avoid a debt crisis from our debt getting out of control, and as a result of that, we can have better, fast economic growth, because we are removing so much uncertainty from the marketplace.

Now we limit ourselves to 10, maybe on the second round I will ask Dr. Holtz-Eakin I had a question I wanted to as you, but I want to be sensitive to members' time. Mr. Van Hollen.

Mr. VAN HOLLEN. Thank you, Mr. Chairman. Let me, again, thank all the witnesses for their testimony. Let me begin with the point that Mr. Aaron made which is that there is agreement that we have got to deal with our budget challenges, especially our growing long-term budget challenges, and much of the testimony was focused on that area of common agreement. As Mr. Aaron also pointed out, the purpose of this hearing is to look at three specific bills. And when you are looking at bills, I hope everybody would agree that details matter because very shortly, this committee will be asked to vote up or down on those and then the full House will as well.

I would just point out, Mr. Chairman, this Brookings Heritage document, Taking Back Our Fiscal Future, makes a number of points in it. I would also just comment on the fact that it says "Myth: Cutting taxes will increase revenues," that is on page 5. It also discusses other alternative to a trigger that in addition to cutting spending would include revenue increases. I dare say that you would be hard pressed to get the individuals—all of the individuals who put their names on this to endorse these three bills. In fact, I am sure many of them would not endorse the bills that are before us because as I said, bills require details, details are important. Let's just talk about some of those details.

Under this bill, under the bill, the first spending cap bill that was put in that would go into effect immediately, I want to make the point that it would require immediate sequester in 2013, even if we passed the House Republican budget for 2013, the one that has already passed the House that goes into effect. You pass the first sequester bill that is on the agenda, it would require a $70 billion outlay cut. So I would like all our witnesses just to very briefly say whether they think that is a good idea going into the beginning of next year.

Chairman RYAN. If the gentleman would yield. These bills are in December on a different baseline.

Mr. VAN HOLLEN. Right.

Chairman RYAN. So new versions of these bills will be changed to reflect the latest numbers from the CBO to conform. It will be a technical thing.

Mr. VAN HOLLEN. In fact, you are making my point, Mr. Chairman, which is those numbers change every year. They change every year, we have seen them change just in the last year, and yet, you are putting in the bill for 10 years a list of assumptions and making cuts based off assumptions. As you have just pointed out, those assumptions change within 9 months, they change more in a year, they change even more in 2 years, and yet you are codifying policies for 10 years. So you are going have that problem every single year.

Now I would like to ask the witnesses to walk through this following scenario, because we have done the math and we are happy to share these with others. If you put these bills into effect, the House passes it next week, let's just say the Senate goes off its rocker and passes it and the President signs it and then you were to have an economic downturn next year, let's say, of the magnitude we just had. We had double dip recession, this would require cuts in fiscal year 2013 by over $700 billion. And the way this is designed, I hope all my colleagues will take a closer look at it, it limits the cuts to some of the mandatory programs, but you still have to hit the overall spending limit cut and the cut of the deficit as a percent of GDP.

So you have an economic downturn, two things we all know happen, number 1, more people become eligible for some of the programs that are safety net programs, a lot of those are cut under the bill, but even with those cuts, some people will get somewhat higher benefits.

Second, you have a big drop in revenue and yet the bill requires that you hit the deficit through GDP target. And what gets wiped out is discretionary spending. You think the cuts to defense in the sequester that we are talking about happening in January are big? They would be huge under this bill if you have another economic downturn next year.

So I just want to ask, our witnesses are distinguished economists, I want to ask each of you whether you think that is a good public policy.

Ms. FRASER. Well, in my view, one of the most damaging things to the economy is maintaining our current course. And I think one the things that can be addressed in this bill is, as you say, when we do have a downturn, but I am not projecting that we do have a downturn next year. So I think that what we need is policies such as are contained in this bill to immediately begin to rein in spending because I believe it is the most damaging thing to our future.

Mr. VAN HOLLEN. Let me just ask you, did you project in 2008 and 2009 an economic downturn?

Ms. FRASER. No, sir.

Mr. VAN HOLLEN. Okay. We can't project things that are somewhat beyond our control. What we are seeing in Europe is an austerity-only approach taken by some countries that has led to double dip recessions.

Mr. Holtz–Eakin, do you think that is a good policy result?

Mr. HOLTZ–EAKIN. A wise man once told me, you should budget for your problem. No budget will be perfect, but you should have a process that solves your biggest problem. Our biggest problem is mandatory spending, even if we don't project downturns, we have enormous fiscal problems. That wise man was Henry Aaron.

Mr. VAN HOLLEN. Go ahead.

Mr. HOLTZ–EAKIN. And that is why I believe these bills are the right thing to do. If, in fact, we revisit something that looks like 2008 and 2009, I find it unimaginable that a Congress would sit and pretend that its hands were cuffed and not respond to the general needs of the American people.

Mr. VAN HOLLEN. As it turns out we have seen changes between the 2011 Republican budget and the 2013 Republican budget that would require 70 billion. So I don't think that changes in the economy are things that we don't expect. We all know that the economy will change in certain ways, and pretending we can freeze in place these particular levels obviously have negative consequences.

Let me ask you, Mr. Holtz-Eakin, a question because you have been on the record about this, with respect to something that is been talked about very much, another budget issue, which is the Speaker's proposal to once again threaten that the United States would not pay its obligations when we hit the debt ceiling. Do you think that is productive?

Mr. HOLTZ–EAKIN. I can't speak for the Speaker, but you did read his remarks very carefully and I did not see that. There was a commitment to meet the obligations of the Federal Government and not to, in any way, default on its borrowing. And there was a principle that increasing the Federal debt limit should be accompanied by comparable dollar amounts of spending cuts or reforms. And I believe the central word in that is "reforms," because that goes straight to the mandatory spending programs are at the heart of our problems. And once again, that takes the form of a fiscal rule that forces the Congress to address the policies which are generating bad outcomes, and I endorse that.

Mr. VAN HOLLEN. Do you think it is productive to threaten that we not raise our debt limit?

Mr. HOLTZ–EAKIN. I do not believe he said that. And I don't think its productive to announce you are going to default on your borrowing and no one has.

Mr. VAN HOLLEN. Well, I think the record will speak for itself. If that is the case and the Speaker has proposed to vote to increase the debt limit that would be news, we will have to find out if that is the case.

Would you agree that the—all the discussion surrounding the August Budget Control Act that that had some—created uncertainty in the economy and creates some negative effects in the economy.

Mr. HOLTZ–EAKIN. Yes, I do believe there was a real negative impact because for the first time, the American people were close to as aware of how dysfunctional the budget process is as this committee is. And that is one of the reasons why I hope similar reforms are made.

Mr. VAN HOLLEN. All right. I would just ask to put in the record some documents from Bloomberg that noted the negative economic consequences to the economy as a result of that sort of standoff last year.

[The information follows:]

[From *Bloomberg,* May 28, 2012]

Debt-Ceiling Deja Vu Could Sink Economy

By BETSEY STEVENSON and JUSTIN WOLFERS

Europe is crumbling. China is slowing. The Federal Reserve is dithering. Yet the biggest threat to the emerging U.S. economic recovery may be Congress.

John Boehner, the leader of the House Republicans, has promised yet another fight with the White House over the debt ceiling—the limit Congress has placed on the amount the federal government can borrow.

If this sounds familiar, it's because we suffered through an identical performance last summer. Our analysis of that episode leads to a troubling conclusion: It almost derailed the recovery, and this time could be a lot worse.

Sometime around the end of this year, the federal government will bump up against its $16.4 trillion borrowing limit, as a direct result of spending and tax laws enacted by Congress. To raise the limit, legislators must pass a separate law. In principle, the extra level of approval can serve as a useful mechanism, forcing Congress to debate its priorities. But refusing to raise the limit wouldn't free the government of its existing spending obligations. Rather, it would leave the government with no choice but to default on its debts.

In other words, congressional Republicans are taking the government's creditworthiness hostage when they threaten not to increase the debt ceiling. Politically advantageous as this may be, it is terrible economics. To understand why, let us consider the economic effects of last year's debt-ceiling debate. If we know our history, perhaps we will not be doomed to repeat it.

CONFIDENCE DROP

High-frequency data on consumer confidence from the research company Gallup, based on surveys of 500 Americans daily, provide a good picture of the debt-ceiling debate's impact (see chart). Confidence began falling right around May 11, when Boehner first announced he would not support increasing the debt limit. It went into freefall as the political stalemate worsened through July. Over the entire episode, confidence declined more than it did following the collapse of Lehman Brothers Holdings Inc. in 2008. After July 31, when the deal to break the impasse was announced, consumer confidence stabilized and began a long, slow climb that brought it back to its starting point almost a year later. (Disclosure: We have a consulting relationship with Gallup.)

Businesses were also hurt by uncertainty, which rose to record levels as measured by the number of newspaper articles mentioning the subject. This proved far more damaging than the regulatory uncertainty on which Republican criticisms of Barack Obama's administration have focused (more on that subject in a Bloomberg View editorial today). Employers held back on hiring, sapping momentum from a recovery that remains far too fragile.

Growth in nonfarm payrolls decelerated to an average 88,000 a month during the three months of the debt-ceiling impasse, compared with an average of 176,000 in the first five months of 2011 (see chart). Payroll growth subsequently recovered and has averaged 187,000 jobs a month since. Despite the rebound in job growth, employment is likely still below where it would otherwise have been.

There are also more visible permanent scars. The sense that the U.S. political system could no longer credibly commit to paying its debts led the credit-rating company Standard & Poor's to remove the U.S. government from its list of risk-free borrowers with gold-standard AAA ratings. Just as a poor credit score raises the interest rate you pay in the long run, so a worse credit rating will probably raise the interest rate on our national debt.

ECONOMIC SABOTAGE

All told, the data tell us that a debt-ceiling standoff is an act of economic sabotage. The only way to avoid this conclusion is to argue that consumers and employers were reacting to some other economic factors. But the debt ceiling was the dominant economic story at the time. No other news fits the data as well. Although the European debt crisis was a rising concern throughout 2011, the real trouble in Europe arose in the period when consumer confidence and employment were recovering.

The next debt-ceiling battle could be worse, because the stakes are even higher. In addition to the threat of default, the U.S. is facing the so-called fiscal cliff: a raft of spending cuts and tax increases that will happen at the end of this year unless Congress acts to postpone them. Another stalemate would almost certainly plunge the economy into a deep recession. Our best alternative—in fact, our only hope—is for Congress to set aside partisan politics and work together with a common goal of helping our country out of the Great Recession.

(Betsey Stevenson and Justin Wolfers, both professors at the University of Pennsylvania's Wharton School, are Bloomberg View columnists. The opinions expressed are their own.)

Mr. VAN HOLLEN. Mr. Aaron, could you just comment on, again, the issue of compounding the negative effects of an economic downturn by locking in some of these bills?

Chairman RYAN. And Henry, try to do it in 39 seconds if you can. You will get other time later.

Mr. AARON. I don't remember making the statement that Doug Holtz-Eakin attributed to me, but I think it makes sense. And it underscores the importance of answering a question that posed which he did not do. The question that you posed to him was what should be done in the face of a serious financial panic and downturn in Europe that threatens to have an effect on the U.S. economy. In that situation, a policy in the United States of cutting spending as would be required under this bill because of the likelihood that the ratio of debt to GDP would exceed the ceilings, because the ratio of spending to GDP would exceed the ceilings, would, in my view, be utter folly. It would be worse than folly, it would be extremely damaging to the economy. The implication I think is that members of both parties would understand that, and this law would be overridden and wouldn't have any effect.

Mr. VAN HOLLEN. Thank you.

Chairman RYAN. Dr. Price.

Mr. PRICE. Thank you, Mr. Chairman. And I want to thank the witnesses as well for your work in the past and for your testimony today, and I think there is some significant agreement, as Dr.

Aaron mentioned, and hopefully, we can get to that from a policy standpoint. I do want to, however, correct the record on the ranking member's, one of the comments he made in his opening statement, and our friends on the other side continue to do this talking about our opposition to closing corporate loopholes for deficit reduction. And the fact of the matter is our budget actually does close significant corporate loopholes. What we——

Mr. VAN HOLLEN. Mr. Price, if I may, that is not—that is not for the purpose of deficit reduction. That is a misstatement.

Mr. PRICE. I will reclaim my time.

Mr. VAN HOLLEN. And you are under clarifying my statement, you are making a misstatement.

Mr. PRICE. It is an interesting process, you just embarked upon.

Mr. VAN HOLLEN. We don't have the chairman here.

Mr. SIMPSON. I am in charge.

Mr. RYAN. Well, we will have Mr. Simpson be in charge.

Mr. PRICE. I think the response to that is curious and points out the fallacy of the statement. We strongly support closing corporate loopholes in the Tax Code, strongly. The fact of the matter is, what the ranking member does has always added that final clause to it, phrase to it for deficit reduction which is something we would gladly do. What we are not in favor is of is increasing revenue, is increasing taxes on either business or hard-working taxpayers across this land to chase ever increasing spending, that is what we are opposed to. And my friend from Maryland——

Mr. VAN HOLLEN. Would the gentleman yield?

Mr. PRICE. No, no, no. You had your 10 minutes.

Mr. VAN HOLLEN. But it is a totally accurate statement, you just confirmed it.

Mr. PRICE. With my remaining 3 minutes after correcting the record from my friend from Maryland.

Mr. Holtz–Eakin, I want to address an issue that we dealt with on this committee in the past, but I know that you have an interest in, and that is the issue of fair value accounting. In an article less than a year ago you stated, "Budget law requires the CBO, Congressional Budget Office, to assume that loans made directly by the government earned huge profits with virtually no risk that such assessments could be wrong."

I think this is one of the areas where the budget process is remarkably flawed and gets us to the wrong answer. So I wonder if you might elaborate on why the current system is structured in this manner and what perverse spending policies does this structure bring about.

Mr. HOLTZ–EAKIN. I actually wrote a letter to Chairman Ryan on this topic which has sort of my full views on it. The short version is that what you want the process to do is reflect the timing and scale of obligations that the taxpayers will have to finance. And in its origins, the Federal Credit Reform Act did something quite desirable, which took loans, loan guarantees and put them on a level budgetary playing field in terms of the timing. At the moment the obligations was incurred, these economically equivalent transactions were recorded in the budget.

What it didn't do was get the scale right, because it did not reflect fully the risks to which the taxpayers exposed, it took a narrow view of risk, the credit risk of the borrower, not the larger market risks for changes and interest rates and economic conditions. It is entirely desirable to do that. If it is done that way, they will be fully on a level playing field and you wouldn't have any budgetary gain moving from one to the other. We saw, for example, in the passage of the Affordable Care Act the use of taking equivalent student loans from the private sector into the public sector at an apparent profit as a way to pay for it, and that is an economic mirage that you shouldn't permit.

Mr. PRICE. And the folks at risk in this process are the taxpayers.

Mr. HOLTZ–EAKIN. Taxpayers, absolutely

Mr. PRICE. Our friends are talking about the student loan issue that you just raised. I wonder if you would elaborate a little bit in just a few remaining seconds about how that issue has been pushed, or the risk has been pushed to the taxpayer in that program.

Mr. HOLTZ–EAKIN. Well, the all new student loans are out of a direct loan program where the portfolio was held by the Department of Education.

Mr. PRICE. All by the government?

Mr. HOLTZ–EAKIN. All by the government. And we have mispriced the risk systematically and we don't fully understand the exposure of the taxpayer to future liabilities out of that portfolio. I am deeply concerned about the quality of that portfolio and the taxpayer risk embedded in it.

Mr. PRICE. As we are as well. Thank you, very much. Thank you, Mr. Chairman, I yield back.

Chairman RYAN. Thank you, Ms. Bass.

Ms. BASS. Thank you. I would like to yield a minute to the ranking member.

Mr. VAN HOLLEN. I thank you, Ms. Bass, I don't need a minute, I just want to put in the record the so-called taxpayer pledge from Grover Norquist, point two that people signed in the supposed any net reduction eliminating deductions and credits unless matched dollar for dollar by reducing—by further reducing tax rates. You don't—the Republican position, anyone who signs this is taking a pledge not to close one tax loophole for the purpose of deficit reduction, just go ask Grover Norquist that is what he said and that is what it says on this sheet.

[The information follows:]

AMERICANS FOR TAX REFORM

United States House of Representatives candidates

Taxpayer Protection Pledge

I, ______________, pledge to the taxpayers of the _____ district

of the state of__________, and to the American people that I will:

ONE, oppose any and all efforts to increase the marginal income tax rates for individuals and/or businesses; and

TWO, oppose any net reduction or elimination of deductions and credits, unless matched dollar for dollar by further reducing tax rates.

______________________________ ______________________________

Signature Date

______________________________ ______________________________

Witness Witness

Pledges must be signed, dated, witnessed and returned to:
AMERICANS FOR TAX REFORM
722 12th Street, WASHINGTON, DC 20005
PHONE (202) 785-0266 FAX (202) 330-5224

Chairman RYAN. Since we are throwing time around——

Ms. BASS. Hey, wait a minute. I did not yield——

Chairman RYAN. Not to rob her time, I just want to ask unanimous consent to include the Speaker's speech in the record which corroborates what Dr. Holtz-Eakin was saying. And I will without objections include in the record.

[The Speaker's speech follows:]

[From the *Washington Post,* May 16, 2012]

Boehner's Debt Ceiling Speech

By EZRA KLEIN

On Tuesday, Speaker John Boehner took the stage at the Peter G. Peterson's 2012 Fiscal Summit and outlined his intentions to again threaten the Obama administration with default in order to extract concessions on spending. I wrote a bit about why Boehner is adopting this strategy in Wednesday's Wonkbook. But here's his full speech:

It's truly an honor to be with you in the historic Mellon Auditorium. It was here in the spring of 1949 that the United States and our closest allies gathered to sign the North Atlantic Treaty, giving birth to NATO.

On that occasion, President Truman declared that people 'with courage and vision can still determine their own destiny. They can choose freedom or slavery.'

In our time, all of these great nations face a grave threat to freedom, one from within, and that is debt. It is shackling our economies and smothering the opportunities that have blessed us with so much.

Once again the world looks to the United States for what it always has: an example. It is the example of a free people whose hard work and sacrifice make up the sum total of thriving towns and a vibrant economy. It's a humble government that lives within its means and unleashes the potential of first-rate ideas and world-class products. It's a nation never content with the status quo and always on the make.

I got a glimpse of this example growing up working at my dad's tavern just outside Cincinnati, and then lived a piece of it running my own small business.

Instead of this shining example, what does the world now see?

A president on whose watch the United States lost its gold-plated triple-A rating for the first time in our history;

A Senate, controlled by the president's party, that has not passed a budget in more than three years;

And, earlier this month, another unemployment report showing that the world's greatest economy remains unable to generate enough jobs to spur strong and lasting growth. If you should know one thing about me, it's that I'm an optimist. Yes, times are tough, but our future doesn't need to be dark. We don't have to accept a new normal where the workplace looks more like a battlefield and families have to endure flat incomes, weak job prospects, and higher prices in their daily lives.

We have every reason to believe we can come out of this freer and more prosperous than ever. And we will, if we confront our challenges now while we still have the ability to do so.

For the solution to what ails our economy is not government—it's the American people.

The failure of 'stimulus'—a word people in Washington won't even use anymore—has sparked a rebellion against overspending, overtaxation, and overregulation.

Nationwide, we're seeing a groundswell of support for bold ideas that reject small politics, cast off big government, and return us to common sense and first principles—the kind of ideas that will restore prosperity and substantially improve the trajectory of our economy.

In March, as part of our Plan for America's Job Creators, the House passed an honest budget with real spending cuts, pro-growth tax reform, and serious entitlement reform. It's a far-reaching effort to control government's worst habits and capitalize on the American people's best. This budget gets our fiscal house in order AND promotes long-term growth. Far from settling for stability, it offers a true path to prosperity.

Various bipartisan commissions and coalitions have devised ambitious plans as well. The math and the mix are different, but the goals are mainly the same.

And of course, there are summits like these that bring together people who just get it. Of course, while I'm happy to be here and I'm sure we all enjoy each other's company, we can also agree that we've talked this problem to death.

It's about time we roll up our sleeves and get to work.

For all the focus on Election Day, another date looms large for every household and every business, and that's January 1, 2013.

On that day, without action by Congress, a sudden and massive tax increase will be imposed on every American—by an average of $3,000 per household. Rates go up, the child tax credit is cut in half, the AMT patches end, the estate tax returns to 2001 levels, and so on.

Now, it gets a little more complicated than that. What will expire on January 1 is cause for concern—as is what will take effect. That includes:

Indiscriminate spending cuts of $1.2 trillion—half of which would devastate our men and women in uniform and send a signal of weakness;

Several tax increases from the health care law that is making it harder to hire new workers; As well as a slate of energy and banking rules and regulations that will also increase the strain on the private sector. But * * * it gets even more complicated than that. Sometime after the election, the federal government will near the statutory debt limit. This end-of-the-year pileup, commonly called the 'fiscal cliff,' is a chance for us to bid farewell—permanently—to the era of so-called 'timely, temporary, and targeted' short-term government intervention.

For years, Washington has force-fed our economy with a constant diet of meddling, micromanagement, and manipulation. None of it has been a substitute for long-term economic investment, private initiative, and freedom Previous Congresses have encountered lesser precipices with lower stakes, and made a beeline for the closest lame-duck escape hatch.

Let me put your mind at ease. This Congress will not follow that path, not if I have anything to do with it.

Having run a business, I know that failing to plan is planning to fail. The real pain comes from doing nothing * * * 'austerity' is what will become necessary if we do nothing now. We'll wake up one day without a choice in the matter. There's also no salvation to be found in doing anything just to get by, just to get through this year. 'Nothing' is not an option, and 'anything' is not a plan. To get on the path to prosperity, we have to avoid the fiscal cliff, but we need to start today. To show my intentions are sincere, I'll start with the stickiest issue, and that of course is the debt limit. On several occasions in the past, the debt limit has been the catalyst for budget agreements. Last year, however, the president requested a quote-unquote 'clean' debt limit increase—business as usual.

So last year around this time, I accepted an invitation to address the Economic Club of New York. I went up there and said that in my view, the debt limit exists in statute precisely so that government is forced to address its fiscal issues.

Yes, allowing America to default would be irresponsible. But it would be more irresponsible to raise the debt ceiling without taking dramatic steps to reduce spending and reform the budget process.

We shouldn't dread the debt limit. We should welcome it. It's an action-forcing event in a town that has become infamous for inaction.

That night in New York City, I put forth the principle that we should not raise the debt ceiling without real spending cuts and reforms that exceed the amount of the debt limit increase.

From all the way up in Midtown Manhattan, I could hear a great wailing and gnashing of teeth. Over the next couple of months, I was asked again and again if I would yield on my 'position,' what it would take, if I would budge * * *

Each and every time, I said 'no' * * * because it isn't a 'position'—it's a principle. Not just that—it's the right thing to do. When the time comes, I will again insist on my simple principle of cuts and reforms greater than the debt limit increase. This is the only avenue I see right now to force the elected leadership of this country to solve our structural fiscal imbalance.

If that means we have to do a series of stop-gap measures, so be it—but that's not the ideal. Let's start solving the problem. We can make the bold cuts and reforms necessary to meet this principle, and we must. Just so we're clear, I'm talking about REAL cuts and reforms—not these tricks and gimmicks that have given Washington a pass on grappling with its spending problem.

Last year, in our negotiations with the White House, the president and his team put a number of gimmicks on the table. Plenty of thought and creativity went into them—things like counting money that was never going to be spent as savings. Maybe in another time, with another Speaker, gimmicks like these would be acceptable.

But, as a matter of simple arithmetic, they won't work.

They won't work, and as I told the president, we're not doing things that way anymore.

What also doesn't count as 'cuts and reforms' are tax increases. Tax hikes destroy jobs—especially an increase on the magnitude set for January 1st. Small businesses need to plan. We shouldn't wait until New Year's Eve to give American job creators the confidence that they aren't going to get hit with a tax hike on New Year's Day.

Any sudden tax hike would hurt our economy, so this fall—before the election—the House of Representatives will vote to stop the largest tax increase in American history.

This will give Congress time to work on broad-based tax reform that lowers rates for individuals and businesses while closing deductions, credits, and special carveouts.

Eyebrows go up all over town whenever I talk about this, but when I say 'broad-based' tax reform, I mean it. We need to do it all * * * deal with the whole code, personal and corporate it's fairer and more productive for everyone.

That's why our bill to stop the New Year's Day tax increase will also establish an expedited process by which Congress would enact real tax reform in 2013. This process would look something like how we handle Trade Promotion Authority, where you put in place a timeline for both houses to act.

The Ways Means Committee will work out the details, but the bottom line is: if we do this right, we will never again have to deal with the uncertainty of expiring tax rates.

We'll have replaced the broken status quo with a tax code that maintains progressivity, taxes income once, and creates a fairer, simpler code.

And if we do THAT right, we will see increased revenue from more economic growth.

Last fall, when I addressed the Economic Club of Washington, I said that making relatively small changes now can lead to huge dividends down the road in terms of debt reduction. As we approach the issue of the debt limit again, we need to continue to bear this in mind.

As you know, we could eliminate all of the unfunded liabilities in Social Security, Medicare and Medicaid tomorrow, and the effect within the Congressional Budget Office 10-year window could be minimal.

That's because changes to these programs take time and are phased-in slowly.

For example, when Congress last increased the retirement age for Social Security, the increase—a mere two years—was scheduled to fully take effect 40 years after the law was enacted. Another example: take the House Budget Resolution and its assumptions for Medicare reform. Those would not even begin until after 2022.

Smart and modest changes today mean huge dividends down the line. Now, I can already hear the grumbles * * * partisans getting all worked up or people saying, eh, let's wait until after the election. We can't wait. Employers large and small are already bracing for the coming tax hikes and regulations, which freeze their plans.

The markets aren't going to wait forever; eventually they're going to start reacting. We now know that we ignore these warnings at our own peril.

That's why the House will do its part to ease the uncertainty surrounding the fiscal cliff. And I hope the president will step up, bring his party's Senate leaders along, and work with us.

Because if there's one action-forcing event that trumps all the rest—even the debt limit—it's presidential leadership. Ladies and gentlemen, I believe President Obama cares about this country and knows what the right thing to do is. But knowing what's right and doing what's right are different things.

The difference between knowing what's right and doing what's right is courage, and the president, I'm sorry to say, lost his.

He was willing to talk about the tough choices needed to preserve and strengthen our entitlement programs, but he wasn't ready to take action.

As it turned out, he wouldn't agree to even the most basic entitlement reform unless it was accompanied by tax increases on small business job creators.

We were on the verge of an agreement that would have reduced the deficit by trillions, by strengthening entitlement programs and reforming the tax code with permanently lower rates for all, laying the foundation for lasting growth.

But when the president saw his former colleagues in the Senate getting ready to press for tax hikes, he lost his nerve. The political temptation was too great. He moved the goalposts, changed his stance, and demanded tax hikes. We ended up enacting a package with cuts and reforms larger than the hike. But it could have been so much more. The letdown was considerable. And, in turn, our nation's credit rating was downgraded for the first time.

Well it should also be the last time that happens, which is why I came here today. If the president continues to put politics before principle—or party before country, as he often accuses others of doing—our economy will suffer and we may well miss our last chance to solve this crisis on our own terms.

But if we have leaders who will lead * * * if we have leaders with the courage to make tough choices and the vision to pursue a future paved with growth, then we can heal our economy and again be the example for all to follow. I'm ready, and I've been ready. I'm not angling for higher office. This is the last position in government I will hold. I haven't come this far to walk away.

Well, NOW is the time to do the right thing.

Let's do it for the right reasons—we don't need to be dragged kicking and screaming. That's not the American way. Let's summon the courage and vision to choose freedom, to choose prosperity, and to determine our destiny.

Then we'll not only have succeeded in solving this crisis—we'll be worthy of that success. Thank you all.

Chairman RYAN. Ms. Bass.

Ms. BASS. I get 2 extra seconds. Thank you for coming today. I actually wasn't going to ask these questions but I did want to follow up on the student loan issue because you mentioned the fact when the student loans were pulled away from the private sector back to the public sector, that that creates problems. Do you think it is better? Should it go back to the private sector?

Mr. HOLTZ–EAKIN. I personally believe that it would be highly desirable to get more private capital involved in the financing of student loans, that is an observation number one. The second observation is really the origination process and the monitoring of borrowers under the current program troubles me. We have recreated some of the worst aspects of the subprime disaster by having those who originate student loans have no stake in their future liability. And so that loan portfolio has terrible incentives embedded in it, and my reading of the evidence, and I have done some papers on this, is that private lenders do it a better job of keeping those who get arrears getting them back current and keeping them out of default, that is important part of——

Ms. BASS. Let me interrupt you, because I would agree on one hand because I think the private sector kind of acted a little bit like a loan shark, but let me just say that isn't it the case that if a student defaulted when it was in the private sector, that it was Federally guaranteed so that the government would wind up paying if the student defaulted?

Mr. HOLTZ–EAKIN. Absolutely. The whole goal was to subsidize lending to those who were going to institutions of higher education.

Ms. BASS. So it is not just a question that the liability is taken away from the taxpayers if we guarantee it. But let me change subjects since my time is limited. You were saying there was no liability. I am not going to yield because I am running out of time.

So another question that I would like to ask when there is an economic downturn, I think about—and especially coming from State government, I think about programs such as unemployment compensation, supplemental nutrition assistance program, how the they automatically expand to protect the vulnerable. So how would statutory limitations in the Spending Control Act, how would that affect the ability, especially of a State government to meet the folks' needs because of unemployment? Coming from California, I have actually asked each of you if you could briefly, because I am steadily watching this clock.

Mr. HOLTZ–EAKIN. My view is that the virtue of these kinds of budget processes, these caps, is they force the Congress to look at the policies regularly. In fact, the best evidence of that is the SGR, where much to the chagrin of the Congress, every year they have to actually look at the Medicare program. Looking at the Medicare program every year is a good idea, and thus the policies can be adjusted for economic conditions and any other policy objectives. The caps putting it on autopilot is exactly the problem.

Ms. BASS. So essentially, we would have a cap that would just be flexible, and it really wouldn't be a cap, a cap spending but if we needed to increase it, you could do that under the Spending Control Act?

Mr. HOLTZ–EAKIN. You could always change the policies to target those in need and still hit the cap or if Congress saw——

Ms. BASS. What if the policies didn't change? So let's just say unemployment is capped in the State of California, which is where I come from, and had to deal with this crisis between 2008 and 2010. If unemployment is capped, and we couldn't issue anymore, what happens to those folks? What happens to the women and the children who run out of—they have no more supplemental nutrition assistance, what would they do?

Ms. FRASER. Well, I think that these are overall caps. And You have discretionary spending caps. You have various categories of caps. I think one of the things that concerns me is that there are almost too many caps. When you are talking solely about SNAP and talking about unemployment, there is not individual caps for these, as I understand it, under any of these bills.

Ms. BASS. Okay.

Ms. FRASER. It gives Congress the flexibility to move resources from one program to another.

Ms. BASS. Thank you.

In my last few seconds, could Mr. Aaron or Dr. Aaron speak?

Mr. AARON. The effect is catastrophic, and the scenario that Mr. Holtz-Eakin and Ms. Fraser have described is unrealistic. What would happen would be that need would rise abruptly. Whether action might be taken would depend on where in the legislative cycle Congress happened to be. Congress would debate these issues. They would hold hearings. There would possibly be filibusters in the Senate. There would be delay.

Ms. BASS. Okay.

Mr. AARON. The result would be that the needs of people who are extremely vulnerable would not be met for extended periods of time, and perhaps indefinitely, depending on what action might eventually be taken.

Ms. BASS. Okay.

Mr. AARON. We have to have a realistic understanding of how things would actually play out in moments of crisis.

Ms. BASS. Thank you.

I am sorry I was cutting both of you off. I was just real cognizant of that big clock. So sorry about that.

Chairman RYAN. We let it go over because we took some of your time.

Ms. BASS. I appreciate that.

Chairman RYAN. Mr. McClintock.

Mr. MCCLINTOCK. Thank you, Mr. Chairman.

First, I would like to remind the ranking member that the top 1 percent of income earners earn 17 percent of the income and pay 37 percent of the income taxes. So if the gentleman were really serious about the rich paying their fair share, he would be arguing for a 50 percent cut. Nobody is suggesting that, but we do think that as we eliminate loopholes, we should not be raising the overall amount that is being paid.

To my colleague from California, who has just left, I would remind her that at the peak of California's revenues in early 2008, when the State was taking in more money than it had ever taken in in its history, it was already running on nearly a $10 billion deficit. That is the problem; a simple inability to say no to reckless, irresponsible spending at both the State and Federal level. We run deficits in good times as well bad.

What I would like to do is pose two observations now to the panelists for comment. My observation is that the single biggest problem we have is very simply that we are allowed to spend more than we take in, so we do. It is much easier to borrow money from the future generation and spend it now than it is to go through the difficult process of saying no to spending or imposing higher and higher taxes. It seems to me the most important single reform that we could adopt to bring our spending back into line is a simple balanced budget amendment. That is the first observation.

The second observation, the second biggest problem that we have, is that mandatory spending is not subject to budget appropriations, and I—what happens is we end up arguing over discretionary—whether discretionary spending should be 1.048 trillion or 1.027 trillion, and completely ignore the $2.7 trillion in mandatory spending that is growing like Topsy, and is sinking our country. So I certainly applaud the Heritage proposal on that.

Final point: It seems to me that except for those two problems, those two flaws, we have got a pretty good process. I mean, we set overall budget parameters, the authorizing committees review these programs regularly to determine whether or not they are worthy of expenditure, and then the Appropriations Committee decides if we can afford them in the budget. The problem is that process is not being followed. It is being ignored.

The Senate has not passed a budget in years. Authorizations have routinely expired, and we keep shoveling money at them, and the appropriators are acting independently of the authorizers. That seems to me to be the problem.

Those are the observations I have drawn for the 3 years that I have been here, and I would appreciate your comments on them.

Ms. FRASER. Yeah. Thank you very much.

I think that you are absolutely right. One of the biggest problems that we have is that we are spending too much. There are a lot of pros and cons of the balanced budget amendment that I don't know if we have time to discuss today, but like the bills under consideration today, a balanced budget amendment would force the Congress to begin to address both our resources as well as the amount that we are spending.

And you know, like any process, it needs to be accompanied by strong policy changes. So what we are looking at are mechanisms that are going to drive policy changes so that we have affordable spending and levels of taxation to cover that, whether that is balancing, or whether, as Chairman Ryan indicated, what we are doing is to drive down the debt to sustainable levels, especially when we consider our global capital markets and so forth.

I absolutely agree that one of the fundamental problems here is that as Congress sets the budget, it is fighting over a smaller and smaller share in discretionary spending as entitlement programs continue to grow. I think that bringing them in some form so they continue to deliver predictable, reliable benefits, bringing them on budget in some way is very important.

Mr. MCCLINTOCK. Since my time is short, may I go to Mr. Holtz-Eakin for his thoughts on those observations?

Mr. HOLTZ–EAKIN. Well, I have testified on the balanced budget amendment. I applaud the notion of putting mandatory spending on a budget, because, in fact, these kinds of fiscal rules give the Congress a way to say no. I think that is one of the most succinct advantages of this.

It is important that these things be in law, because the problems we have, there is no shortage of information. The CBO puts out——

Mr. MCCLINTOCK. Let me just cut right to the chase. With those two exceptions, the balanced budget amendment and the mandatory spending being brought within the budget process, is there really anything wrong with our process except that it is not being used?

Mr. HOLTZ–EAKIN. I believe the other additional improvements in this are to force the President to agree with the Congress and have the Congress agree between the House and Senate on a budget. We do not do that at the moment, and that is a huge flaw.

Chairman RYAN. Thank you.

Mr. Mulvaney.

Mr. MULVANEY. Thank you, Mr. Chairman.

I am glad to hear that at least there is a starting point at some agreement here across the aisle, and that, as Mr. Aaron put it, at least we agree that something has to be done, and that is encouraging. I think that is an advance over where we were probably 2 years ago when one side was saying, let's do something about the deficit, and the other side was saying, let's not worry about the deficit. So at least we have made that progress.

But I think at the end of the day, that is probably not nearly enough. We can't just agree that we are going to have to do something and then not actually do something.

So I do want to talk a little bit about the BOLT Act, and I want to go to Mr. Aaron for a second, who was critical of it at a couple of different places.

Mr. Aaron, I encourage you to consider the fact that the act does not completely exclude considerations for revenues or new taxes. It doesn't set caps, and we will talk about caps for a second. I understand you don't agree with those necessarily, but would you agree with me, sir, that there is nothing in the BOLT Act itself that automatically excludes the consideration of additional revenues, closing of loopholes, or new taxes?

Mr. AARON. There is nothing that any law could do to prohibit Congress from considering new taxes. Obviously, that is always within their prerogatives. The question is whether the procedural imperatives in the bill symmetrically and equally deal with the revenue and expenditure sides of the budget, and it doesn't.

Mr. MULVANEY. And I can see that perspective. I thought you were taking the point that it was sort of like the most conservative version of the balanced budget amendment, which would have a supermajority necessarily raising taxes.

Mr. AARON. No.

Mr. MULVANEY. Okay. So I see that you disagree with the philosophy of it embraced in, for example, the caps. Let's talk about that.

And one of the sets of caps in the bill sets total spending at 20 percent of GDP, which I take it is something you would object to. Let me ask you a philosophical question as I sit here and try and build bipartisan support for this bill. Would you take it if it was 25 percent?

Mr. AARON. No.

Mr. MULVANEY. How about 30?

Mr. AARON. I don't believe that any current Member of Congress is sufficiently wise to set a limit on what the size of the Federal Government should be regardless of circumstances. I think that is a prerogative of Members of Congress to decide that they should face the substantive issues involved and not rely on formulas.

Mr. MULVANEY. That is fine. Let's exclude war, because I think that is something we would all agree on would be an emergency situation, or we might have to blow it through a cap. And I will just ask you a very simple question. Excluding war, is there any size of the Federal Government that would objectionable to you in terms of percentage——

Mr. AARON. Oh, sure. Lots of sizes of the Federal Government that would be objectionable to me.

Mr. MULVANEY. Give me a number.

Mr. AARON. No, I won't give you a number. If you want to give me substantive policies, I will deal and respond to them, but I think dealing with numbers is an avoidance mechanism.

Mr. MULVANEY. Well, dealing with numbers——

Mr. AARON. Let's deal with the specific policies involved. Is Social Security larger than it should be? Is Medicare larger than it should be? Is national defense larger than it should be? Let's talk about policy, and then we can have an informed debate. If we are talking about numbers, we are talking about what I regard as a kind of mindless abstraction.

Mr. MULVANEY. Well, unfortunately on the Budget Committee oftentimes what we have to do deal with is numbers.

Talk about the long-term projections. I understand the objection generally, understanding a little bit about how numbers work and about basic economics, that it is difficult to anticipate 5 or 10 or 20 years out. It was difficult to predict at the end of 2007 that we would have a recession just a couple of months later. But we do it at a certain level every day, don't we? I mean, we do 75 years, for example, with Social Security. It is not accurate, it is not perfect, but would you agree with me that it is better than doing nothing at all and just flying blind on a day-to-day basis?

Mr. AARON. I believe it is very important and valuable to do long-term projections. Exactly how far out one should look into the future, I think, varies depending on the program and the circumstances.

With respect to Social Security, it seems to me 75-year projections are valuable. With respect to Medicare, I don't think they make a whole lot of sense because we have no idea what is going to be forthcoming in the way of medical technology down the road. But still, multiyear, 25, 30-year projections, it seems to me, are extremely valuable.

What is not valuable is tying or requiring current actions to be taken to change the system in response to those projections, because we do know for a fact that historically they have been wrong by vast amounts. So as long as Congress is aware of those numbers, is doing those projections, is incorporating them into its debate about what current policy should be, I think you have gone exactly the right distance. If you introduce requirements that legislative actions be taken now in response to those projections of the distant future, I think you have gone a step too far.

Mr. MULVANEY. Thank you.

Thank you, Mr. Chairman.

Chairman RYAN. Mr. Huelskamp.

Mr. HUELSKAMP. Thank you, Mr. Chairman. I appreciate the opportunity to ask a few questions here in between committee meetings in another room here.

First I want to start with—follow up with Mr. Aaron and your response to some questions from my colleague here. And you talked about numbers avoidance and mindless—what was that word you used, mindless——

Mr. AARON. I don't remember exactly what it was. It is in the record.

Mr. HUELSKAMP. I am just trying to follow it. I am just trying to follow the numbers. I do have a numbers question for you.

Mr. AARON. Yes.

Mr. HUELSKAMP. And given the current projections on growth—and I know you indicate that they are usually horrifically wrong. They are usually horrifically wrong in the same direction.

Mr. AARON. That is not true. It can be wrong in either direction. We——

Mr. HUELSKAMP. It certainly could, but if you look at the projections of our entitlements, they have been horrifically underguessing the cost since the beginning, particularly on Medicare.

Mr. AARON. On Medicare there was a long period in which there were severe underestimates. In the case of Social Security, the estimated cost has been more or less on target for about the last 15 or 20 years. It has varied very little. It has gone up and down.

Mr. HUELSKAMP. Sure. Sure.

Mr. AARON. It has moved in both directions, but we are back at about where the projections were 20 years ago.

Mr. HUELSKAMP. Yeah, and I appreciate that. But the issue of numbers is pretty important. In your estimation how much longer can our Federal Government continue to run $3- to $4 billion deficits every day? How long can that continue to occur, in your opinion?

Mr. AARON. I think it is, under current economic circumstances, on balance beneficial, a serious effort to reduce——

Mr. HUELSKAMP. You think it can go on forever then? And the question was how long do you think it can go? You think it can go on forever then?

Mr. AARON. I was in process of trying to answer your question.

The question of whether a deficit is helpful or harmful depends on the economic circumstances. Once the economy—the economic recovery is well established and well under way, I believe it is of urgent importance for Congress to take aggressive measures to reduce Federal budget deficits. An indefinite expansion of the national debt can do enormous harm to this country, could precipitate serious economic crisis, and I believe in the end Members of this body and the Senate will jointly prevent that from happening. Currently——

Mr. HUELSKAMP. Okay.

Mr. AARON. Currently, in the midst of a recession, an attempt to balance the budget, it seems to me, would do considerable harm.

Mr. HUELSKAMP. Okay. And I agree. I agree. And under the President's budget proposal, it didn't balance for 75 years. How much harm does that do if the President never proposed to ever balance the budget in the 75-year window?

Mr. AARON. I think that if one looks at the projection of the Congressional Budget Office, under current law, under current law, you will discover that the budget deficit comes down sharply and reaches a very sustainable level. Current law, as opposed to current policy, would entail significant tax increases and spending cuts. Current law would not permit Social Security to spend more than they have collected.

Mr. HUELSKAMP. May I interrupt? The President's budget never balances. It never gets to a surplus in 75 years; never, ever.

Mr. AARON. But the debt-to-GDP ratio comes down.

Mr. HUELSKAMP. The question as I ask and as you answered was, can you run deficits without economic harm? And you said, when you have an economic recovery, you should not run deficits. I agree with that statement. That was the statement that you gave, Mr. Aaron. I am just trying to figure out——

Mr. AARON. But I still think we should take aggressive measures to reduce the deficit.

Mr. HUELSKAMP. Okay. I am just trying to get answers.

Mr. AARON. I am trying to answer.

Mr. HUELSKAMP. Okay. Well, let me ask it again, if I might. Do you think we should ever run a surplus——

Mr. AARON. Oh, yes.

Mr. HUELSKAMP [continuing]. In the next 75 years? How about in the next 75 years? Any time do you see an——

Mr. AARON. I don't have a specific date, but there are many circumstances under which a budget surplus would be highly desirable.

Mr. HUELSKAMP. Okay. I agree with that. And again, the President's budget proposes to never run a surplus in 75 years, in 75 years, and the tremendous damage that could do to our economy if we don't look at entitlement spending—a year ago, by the way, was the anniversary of a vote in the House on the President's demand that we have a clean debt limit increase; clean, with no cuts, no proposals, and no idea what we are going to do for the next—I don't know what his budget was, still 75 years of null on balance as well—but an anniversary, and the House wisely said no including—it was a bipartisan no, that we should do something.

Do you think that we should do a clean debt limit increase in December again, assuming that is when we hit the debt ceiling again?

Mr. AARON. I believe the debt ceiling should be completely separate from consideration of spending and revenue decisions. The debt ceiling is breached because of decisions that Congress has made in the past. If it wishes to change those policies, it should do so, but the idea that we are going to not raise the debt ceiling in the face of decisions that a majority of Congress has voted on and the President has signed seems to me to be to link policies that should not be linked.

Mr. HUELSKAMP. I appreciate that opinion.

Thank you, Mr. Chairman.

Chairman RYAN. We have another Member Mr. Campbell, who is an author of one of these bills coming, so I will just start round two, if that is okay with the panel, if you have the time, in order to buy some time for him to come.

Let me start. I have got a question for—I wanted to ask Dr. Holtz-Eakin a question about some CBO baseline issues, but before I get into that, I am kind of puzzled at the premise of the arguments used against these reforms, which were derived from this bipartisan working group document. And it kind of goes like this: We have a spending-driven debt crisis coming in this country. We all know that. It will threaten our economy and put us into an economic meltdown, or a recession, or a slowdown, whatever you want to say. And so in order to prepare for that eventuality, we don't want any spending caps so that we can spend more money to fight the fire at that time, which, you know, I know a lot of people believe in the demand side argument that is there.

What we are trying to do here is prevent that from happening. What we are trying to do here is address the drivers of this spending-driven debt crisis so that we don't have a debt crisis, so that we don't have a recession stemming from a debt crisis. That is the whole purpose of this.

And so if you want to look at where we are headed, it is Europe, because we are on the same path. That is what austerity is. Austerity is once the crisis has hit, once your yield curve starts going nuts, the bond markets have turned on you, massive surgery right away, indiscriminate across the board, pull the rug out from current seniors, raise taxes, slow down the economy, youth unemployment rate 21 percent, on, and on, and on. And that is because governments have overspent. Governments had made promises that they can't keep, and now they are broken promises to lots of people.

But we are trying to preempt that from happening, prevent that from happening, by getting at the source of this problem: a spending-driven debt crisis. And what we have learned around here is that this process not only is not broken, it is not even working, it is not even being used. There is no budget process. There is no budget. Haven't had one for 3 years. And that means we are sticking with the status quo, which means we will have a debt crisis, which then, yeah, I suppose if you believe in the Keynesian, you know, demand-side stimulus argument, you want to be ready with the buckets of spending to throw at the fire.

But what we want to do is put together a budget process that actually works to actually deliver on the fiscal targets to actually get Congress to put these reforms in place to prevent that crisis from ever occurring in the first place. That is what this is all about.

And so when we see a working group of people with impressive credentials from both sides of the aisle coming to a consensus on some natural ideas on how to attack this problem, knowing that it is not a substitute for actually passing the laws that fix the problem, but are good backups, good enforcement mechanisms, good measurement sticks to make sure that Congress gets on task to actually fix the problem, we see that as productive. We see that as a constructive step in the right direction.

And as I mentioned at the beginning, no one party is going to fix this thing on its own. There will have to be, you know, bipartisan agreements at the end of the day here to fix this mess. And what we see in front of us is a narrowing window of opportunity to do that in before we have a European-like crisis on our doorstep. That is the whole point here.

It is the baseline issue I wanted to get to you, Doug. When you were Director of CBO, when you are running the baseline, there are times that administrative decisions increase CBO's estimate of spending even though the underlying statute did not change. The administration will take actions that they believe they have the authority under the law to do. How does CBO score that action?

We had a VA issue, or I think they had an actuarial misfire which resulted in a change administratively that resulted in $13 billion in more direct spending. This year we have got Medicare Advantage cuts that are coming, which I think, likely for political reasons, a new demonstration project was formed, which has something like $8.35 billion in spending to delay those cuts, which will clearly accrue to adverse benefits for people currently on Medicare Advantage before the end of the year. How does CBO deal with this?

Mr. HOLTZ–EAKIN. Very straightforwardly. So a concrete example, Medicare Modernization Act passed, the prescription drug bill. CBO had a score under my tenure on that bill as it was passed. When HHS implemented the bill, they actually implemented a tighter formulary than we had anticipated that would come out of the bill. As a result, access to high-cost drugs was more limited than we expected, and the bill actually turned out to be cheaper, and we had to mark down in the baseline the expected Medicare outlays to reflect that. And it goes on all the time, in every program. What stands out are ones of large magnitude like the VA. Those are relatively unusual.

Chairman RYAN. Time is up. Let's go to you, and then we will see if Mr. Campbell gets here.

Mr. VAN HOLLEN. Mr. Chairman, let me again thank the witnesses. Thank you, Mr. Chairman.

Just to go back to the overall point that the chairman raised where there is consensus is that we need to reduce our deficits, especially as they are projected to rise over the long term. That is where there is consensus.

Yes, there is a spending component. We recognize that. There is also a revenue component. Apparently our Republican colleagues do not recognize that component, at least not as part of the solution, despite the fact that every bipartisan group that has looked at that challenge recently has concluded that the way to tackle this problem is through a combination of policies that lead to spending reductions and policies that will increase the revenue component. And putting process bills forward in the absence of an agreement on the underlying policy issues is putting the cart before the horse, and I think that is what the testimony has been about.

Mr. Holtz–Eakin, I mean, I would assume—I have some statements you made when you were the Director of the Congressional Budget Office, and I think from your testimony today you would agree with your earlier statements.

Let me just read: "The statutory"—this was 2004. Quote: "The statutory budget disciplines that expired in 2002, the limits on discretionary spending, and the pay-as-you-go requirement for new legislation affecting entitlements and revenue prove to be an effective enhancement of the budget process."

Do you agree with that?

Mr. HOLTZ–EAKIN. Yes.

Mr. VAN HOLLEN. Okay. Do you know that this bill, the first one, Mr. Campbell's bill, eliminates the statutory pay-as-you-go requirement? Are you aware of that?

Mr. HOLTZ–EAKIN. I am aware of that, but it is a completely different approach. I mean, there are many ways to support the budget——

Mr. VAN HOLLEN. I am just saying that, as I understand, you agree that it was an effective enhancement to the budget process in the past. I am not saying there aren't others, but you would agree then that this legislation eliminates one effective budget-control enhancement. Would you agree with that?

Mr. HOLTZ–EAKIN. But I would stipulate it adds others. So, I mean, that is——

Mr. VAN HOLLEN. I know, but they are taking one tool out of the toolbox, right?

Mr. HOLTZ–EAKIN. And again, you have to budget for the circumstances in which you find yourself. PAYGO rules and discretionary caps—I mean, the PAYGO rules in particular stop you from making it worse, but there is nothing there that forces the Congress to make it better.

Mr. VAN HOLLEN. Mr. Holtz-Eakin, I agree with you. Stopping us from making it worse is a good thing. I mean, it doesn't solve the problem, but it is a good thing.

I assume you also continue to agree that these kind of process reforms are most effective when there is an agreement on the underlying policies.

Mr. HOLTZ–EAKIN. I think everyone has said from the outset this is not a substitute for better policy.

Mr. VAN HOLLEN. Mr. Aaron, if you could just elaborate on—well, let me just make this point, because, Mr. Chairman, you referred to this document a couple of times. Again, I think—I mean, I have looked at this document. I think it is a long way from this particular document to the three particular bills, especially the two bills that we are talking on, and I would just say——

Chairman RYAN. They are not meant to be a complete—all of the points of the document. Some of the other bills we passed before——

Mr. VAN HOLLEN. Right.

Chairman RYAN [continuing]. Out of here in that document, these are three of the ideas being recommended in the document.

Mr. VAN HOLLEN. Well, I would—just to be clear, I mean, it would be useful, I think, to ask every individual who is on this bipartisan group whether they agree with the three specific bills, because I daresay you would find a lot of Members whose names are on here who do not agree with the details, as Mr. Aaron has pointed out, of these bills. But——

Mr. AARON. May I say something at this point?

Mr. VAN HOLLEN. Sure.

Mr. AARON. As it happens, yesterday afternoon, as I was completing my testimony for this, Isabel Sawhill, who was a colleague at Brookings, and who is a signer of that particular document, walked by, and we had a brief conversation. I think you will find she is not sympathetic with this particular approach.

In addition, I would like to mention and make available, should you wish it, a document that I was a party to that responded to the Taking Back Our Fiscal Future document that the chairman has mentioned. It, too, was signed by a lengthy roster of very distinguished economists, including one Nobel Prize winner, a former director of—a former CEA chairman, and a number of others in many ways, I think, as distinguished as the list that signed Taking Back Our Fiscal Future. This document indicated why we thought the approach taken in this document was flawed, and I would like to make it available to the committee, if you wish.

Chairman RYAN. I would love to see what your board meetings at Brookings Institution are like.

Mr. AARON. Well, I think——

Chairman RYAN. That is a big think tank you have got there.

Mr. AARON. It is worth noting that the Brookings Institution is, I think, the only think tank around where you can have senior members of staff debate each other, holding different positions, as, for example, Alice Rivlin and I do on the issue of the——

Chairman RYAN. We enjoyed—I am digressing here.

Mr. Campbell, I guess, is not going to show up. But we had a nice hearing at Ways and Means where Dr. Rivlin and Dr. Aaron debated each other on the issue of premium support. So you have got all sides of representation over there at Brookings.

We will just close it out with Mr. Mulvaney.

Mr. MULVANEY. Thank you, Mr. Chairman. I appreciate the second opportunity to ask just a couple of questions and move away from the bills, because one of the other things we get a chance to do on this committee is talk generally about ideas and policies, in addition to the specifics of bills. And you have heard a couple of things mentioned here during the course of today's discussion that I want to touch on very briefly before we go, which is the situation in Europe, and then also the debt ceiling.

Ms. Fraser, I know it is very difficult to sort of sum up the causes behind the current situation in Greece, and Ireland, and Portugal, and Spain, but is it fair to say that overborrowing by those sovereigns, by those governments, is a major contributor to what is happening and the difficulties they are experiencing in those countries today?

Ms. FRASER. Yeah. In my view, it is a part of overborrowing. They are spending too much. They are borrowing to do it. I think they also have large government. But they also don't have growing economies. And that is one of the biggest problems that they face right now is how do you rein in spending to stabilize your debt when you have a recessionary kind of economy that is not robust.

And I think that is one of the advantages that we have in this Nation when it comes to solving our own problems is that we do have the underpinnings of a robust economy even though we are not growing at our capacity today.

Mr. MULVANEY. And I think several of you mentioned the fact that if we don't do something differently—I will paraphrase. I don't want to misquote anybody. Unless we do something differently, we may well be facing a similar type of future as to what they are facing in Europe today.

Dr. Holtz–Eakin, what would it look like in this country when we start to go through what Europe is going through today? Tell me what that would look like for the folks in this country.

Mr. HOLTZ–EAKIN. What it would look like is something that would make 2008, 2009 pale in comparison. You would have credit markets freeze up, inability of private borrowers to get even ordinary financing for their inventories and things like that. Main Street America would crumble. And in those moments international lenders would demand of the U.S. changes to the Federal budget that would be unpalatable to every American, but about which we would have no choice. There would be sharply higher taxes and slashes in spending that have nothing to do with thoughtful policy.

Mr. MULVANEY. Thank you for mentioning that, because that is the point I am getting at that I don't think folks grasp back home, which is that we are going to get to the point where people don't want to lend us money under the same terms they have been lending us money. We can print it, but that is another debate for another day. But we could get to the point where folks don't want to lend us money at half a percent, or 1 percent, or 25 basis points. They are going to ask for much larger spreads, which is exactly what is happening in Greece.

So it comes to one of the overall discussion, Dr. Aaron, of when you are faced with that, when you are faced with interest rates of 6 or 8 or 10 percent, which are numbers that we have incurred as a government during my lifetime for our debt, how do you borrow your way out of that difficulty?

Mr. AARON. You don't.

Mr. MULVANEY. But one of your criticisms of my BOLT Act was it didn't give you the flexibility that you needed to borrow money and to grow the size of the government when you go into a recession.

Mr. AARON. The United States currently is so far from the situation that I think Doug has correctly described could occur if debt piled up for an extended period of time that we are in a completely different world. The world we are in right now is one in which the United States remains the most secure and reliable borrower in the world, in which we are operating well below our economic capacity, and in which, in my view, the first and overwhelmingly the most important task facing our Nation is to get U.S. workers back on the job, to increase employment, to reduce unemployment, to avoid the human tragedy that is resulting for millions of people coming out of school and not being able to find work. And for that reason the first and most important problem is to increase the demand for the services of American workers. That should include tax policy that encourages private spending. It should include government expenditure that supports demand and provides essential services.

We are going to return to full employment, and when we do, we have got to reverse that engine and begin to get our Federal budget under control.

Mr. MULVANEY. Thank you.

Mr. AARON. I think it is a key to understand which problem comes first and the vital need to solve it.

Mr. MULVANEY. I appreciate that.

Finally, Mr. Chairman, I do want to touch very briefly on the debt ceiling issue that the ranking member raised. And I always enjoy dealing with folks who do pay attention to language and do pay attention to details is one of the things that I appreciate about the ranking member. And I couldn't help but notice the details of the language that you are using now in the discussions about the debt ceiling, which is no longer that this side is threatening to default on our debts, default on our obligations. The language is now "meeting our obligations." I think this is sort of taking the veil off of the accusations last year that we are going to default on our debt. We heard it. We heard that if we didn't raise the debt ceiling, we would default on the debt. And I think we have put the lie to that. We are never going to default on our debt, because we have plenty of money to pay the debt—to pay our interest obligations. Similarly, we are always going to pay our Social Security obligations. We are going to continue to do those things.

I think it is interesting to hear the language from the opposition now who has changed from "defaulting on our debt" to "meeting our obligations." I am interested to hear that language as we go through the discussions between now and the end of the year.

Mr. VAN HOLLEN. Mr. Chairman, if I might, since the gentleman referred to a comment I had made. I would like to put in a record a transcript of a YouTube posting by Mr. Holtz-Eakin on what would happen in the event that we had a—we hit the debt limit, including not making full payments of Social Security and zeroing out, I might add, defense spending and all other discretionary spending, among other things.

[The information follows:]

Eakinomics: Raising the Debt Limit - American Action Forum President Douglas Holtz-Eakin walks through the ramifications of not raising the debt limit.

Posted by The American Action Forum on May 17, 2011

Transcript

Hi, I'm Doug Holtz-Eakin, President of the American Action Forum

Some people have talked about not raising the federal debt limit – let's play that out for a second.

Right now the federal government is pulling in about $2.3 trillion, so this revenue would be all it had because it could not borrow anymore.

Now, you could pay the interest on the debt and not default – that is about $300 billion. But having done that, you would have to stop right there (draws a line on a vertical bar graph at $2.3 trillion) with what was left over, you couldn't pay all of the mandatory spending – about $2.1 trillion – meaning not all of the Medicare, not all of the Medicaid, not all of the Social Security, Farm Programs, those kinds of things. And this, annual discretionary spending, $0. That means: no money for the troops, no money for procurement or transportation of materials, no education, no highways, no infrastructure, and no basic research.

And even more striking, the decision – what gets the money and what doesn't – gets made by the executive branch with no input from Congress. That's unlikely to happen – we're going to raise the debt ceiling.

Chairman RYAN. I am sure that the hits will spike now.

Mr. HOLTZ–EAKIN. Thank you for the advertisement.

Mr. VAN HOLLEN. Absolutely. I actually hope a lot of people will turn to it. It was a well-done tape.

Chairman RYAN. Thank you for your indulgence. We will conclude it here. The hearing is adjourned.

[Whereupon, at 11:38 a.m., the committee was adjourned.]

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